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The Use of Credit-Based Insurance Scoring in Iowa

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Contents

Executive Summary

Credit-based insurance scoring, or insurance scoring, is an often studied and controversial issue. Insurance scores are defined by the Iowa Code as numbers or ratings that are derived from an algorithm, computer application, model, or other process that is based in whole or in part on credit information for the purposes of predicting the future insurance loss exposure of a consumer.[1] At the request of the Iowa Commissioner of Insurance, a study was conducted by the Consumer Advocate to determine the best insurance scoring policy for Iowa. As part of the study, research was conducted throughout 2009 and 2010 that included prior studies, public hearings and testimony, reviews of insurance score models, reviews of complaint data, an information request from insurers, and an Iowa consumer opinion survey.

Background of Insurance Scoring

Insurance scoring has become an industry standard for auto and homeowner's insurance over the last decade. Insurance scores are calculated by insurers (or a third party vendor) and can be applied to consumers during the underwriting and rating process. In underwriting, an insurance score may be used to help determine if a consumer qualifies for a policy. Once qualified, an insurance score may be used to assign affiliate placement.[2] After an affiliate is selected, the consumer is placed in a subgroup based on insurance score, commonly known as a tier. All tiers are then assigned a number value that is multiplied by the rate (a differential) that may result in a discount or surcharge. In the end, an insurance score may have multiple opportunities to influence the price of insurance.

To understand the major issues of controversy for insurance scoring, a review of prior studies was conducted. One of the controversial issues reviewed was causation versus correlation. The source of controversy for causation versus correlation is the insurance industry's inability to establish an accepted cause for the claims propensity insurers have shown with statistical correlations. Another major issue that is raised by consumer groups is the impact of insurance scoring on minorities and insurance access. Consumer groups point to studies that show a disproportionate impact on minorities and low income consumers. There have even been court challenges to insurance scoring based on disparate impact (a type of discrimination). But proponents of insurance scoring reiterate that race information is not collected or used in insurance scoring calculations and that the predictive ability of insurance scoring benefits the marketplace as a whole. Though these issues have been studied, resolution and agreement have not been reached.

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[1] Iowa Code § 515.103 (1)(h) defines insurance score as "a number or rating that is derived from an algorithm, computer application, model, or other process that is based in whole or in part on credit information for the purposes of predicting the future insurance loss exposure of a consumer".

[2] Iowa Code § 515.103 defines affiliate as "any company that controls, is controlled by, or is under common control with another company."

Insurance Scoring Laws

Insurance scoring is subject to consumer protection laws at the national and state level. At the national level, the Fair Credit Reporting Act provides guidance to credit reporting agencies and to companies that obtain credit reports. One of the guidelines requires companies to provide notice to a consumer if an adverse action is taken based in whole or in part on information obtained in a consumer's credit report. The Fair Credit Reporting Act also provides procedures for consumers to challenge inaccuracies in credit reporting.

On the state level, the National Conference of Insurance Legislators (NCOIL) model act is used by nearly half the states for insurance scoring, including Iowa. In 2009, the NCOIL model was amended to add an extraordinary life circumstances exception. However, varieties in state insurance scoring laws remain within various states enacting provisions to address specific concerns.

Iowa Data

The top ten insurers in auto and home insurance were asked to participate in an Iowa Insurance Division information request. The request contained five questions regarding policy totals, tier placement, pricing, and neutral treatment. The data received from the companies in response to the request revealed trends in three areas: policy distributions, neutral treatment, and pricing disparities.

The request asked companies to provide the total number of policies for 2008 and the tier placements for those policies. When the Division analyzed the insurance scoring information, 662,585 policies were grouped into categories of discount, neutral, and subpar (below the neutral tier). The policy distributions showed that more than half of the policies reported received premium discounts due to insurance scoring in both homeowners and auto insurance. A total of 146,647 policies, or 22%, of the insurance scored polices received surcharges for falling below a neutral tier. Three companies applied neither a discount nor a surcharge when a consumer received a below neutral score.

For consumers who lack credit history or have credit history files so small insurance scores cannot be calculated, insurers are required by Iowa law to treat them neutrally. The law also permits the definition of neutral to be determined by each company. The responses provided by the information request demonstrated that companies differed in the way they provided neutral treatment, in that there were inconsistencies in the application of rating laws and pricing of consumers whose credit information places them in a neutral rating tier.

To get a sense of the pricing difference cause solely due to insurance scoring, insurers were asked to provide the premium prices for each tier based on the same hypothetical consumer. The pricing disparities reported from the participating insurers showed that a range of prices can be found by consumers who may be shopping for insurance. Depending on how insurance scoring is treated by each insurer, the difference in price is extreme, ranging over $1000 solely due to insurance scoring when reviewing the lowest and highest prices.

Consumer opinion on insurance scoring was reported to the Division in three ways: public hearings, consumer testimony and complaints, and an Iowa consumer opinion survey. Consumers and other interested parties were given three opportunities to participate in public hearings. Each hearing included presentations detailing specific areas of insurance scoring and included written information from the presenters that could be added to the public hearing record. The areas included: the current law and application of insurance scoring in Iowa; how insurance scores are calculated and the role of the third-party vendors; and consumer protection concerns. Consumers were extended the opportunity to comment at every public hearing and chose to do so at the first and third hearing.

Consumer information from written testimony was combined with 5 years worth of consumer complaints. The main concerns expressed by consumers showed trends. These trends could be broken into three broad categories of concern regarding insurance scoring issues: causation, fairness in relation to a consumer's economic status, and transparency. Consumers concerned with causation (36.5%) disagreed that credit information truly related to home and auto insurance. Complaints and testimony related to transparency (15.8%) expressed that insurance score models should be public, so consumers could attempt to improve their rates. The largest group of complaints came from consumers who felt insurance scoring was unfair because insurance scoring based on their credit report history did not accurately reflect their fiscal situation or history of responsibility and therefore did not accurately representative of their individual insurance risk. This included both consumers who were experiencing financial hardships outside of their control and their credit as well as consumers who wished to be fiscally conservative and have paid off all of their debt.

To complete consumer opinion information, a survey was conducted of Iowa auto and homeowner's consumers by St. Ambrose University. The survey was taken from across Iowa and matched to Iowa's demographics as closely as possible. The survey was to test consumer's knowledge of the use of insurance scoring, gather opinions on fairness, and to determine if Iowa's minorities were experiencing a disproportionate impact due to insurance scoring. The results from the questions regarding knowledge showed that Iowans were not knowledgeable on the use of personal credit in insurance. Respondents also did not find the practice to be fair. The last question regarding disproportionate impact could not be confirmed by testing due to the small data sample available. St. Ambrose University conducted analysis on the results of the survey and recommended policy makers view insurance scoring as impartial and implement mechanisms to address imperfections. Consumer education was also recommended by the survey's authors, on the topics of insurance and credit information.

Findings

To obtain the best insurance scoring policy for Iowa, consideration should be given to multiple areas. Consumer protection must be considered as the Commissioner of Insurance has a statutory duty to protect Iowa's consumers. But consideration must also be given to the fact that both consumers that do and do not receive a discount are both owed the duty of protection. As divergent groups, their ideas of fair will contradict one another. The unique fact that Iowa has the lowest premiums in auto insurance and has one of the lowest average homeowner's insurance premiums must be taken into account in making policy decisions also. Low insurance rates are important because consumers do not appreciate insurance premium increases. Iowans have become accustomed to paying among the lowest rates in the nation for both homeowner's insurance and auto insurance. Consumers have an interest in maintaining low rates and the Insurance Division would likely face consumer criticism for allowing a significant home and auto insurance rate increase. Therefore, the best insurance scoring policy for Iowa must provide consumer protections that consider all consumers served by the Commissioner of Insurance as well as maintaining the low insurance rates Iowa has enjoyed over the past decade.

In light of the research and concerns in the study, the findings are as follows:

1) Though no conclusions of disproportionate impact were found on the Iowa Consumer Survey, other regulators have discovered disproportionate impacts to minorities and low income consumers.
2) Iowa law lacks meaningful guidance in some areas for insurers.
3) An insurance score alone can cause a dramatic range in premiums.
4) Iowans are facing more unexpected life changes in the current economy.
5) Pricing increases at the time of renewal motivate most complaints.
6) Consumer concerns about the inability to obtain information on how to specifically improve their insurance score are legitimate.
7) The Iowa consumer opinion survey showed respondents did not find insurance scoring to be fair. Respondents also failed to understand the importance of monitoring and maintaining credit in current times.

To achieve the best insurance scoring policy for Iowa, the following recommendations should be implemented:

1) Require any recalculation of insurance scores upon renewal be to the benefit of the consumer and never a detriment.
2) Provide insurers with additional guidance in filing rates and defining neutral treatment.
3) Increase the transparency of insurance scoring by requiring additional notices and disclosures to consumers.

4) Increase consumer understanding on the importance of credit information through outreach.

I. Background of Insurance Scoring

A. The Study Question

Iowa law permits insurers to use a consumer's personal credit history as a factor in underwriting and rating in personal insurance lines.[3] The practice, known as credit-based insurance scoring or more commonly as insurance scoring, is a controversial issue. To better understand insurance scoring's controversy in regards to Iowa, the Iowa Insurance Commissioner requested a study to investigate the use of insurance scoring and to provide recommendations for its continued use. The findings and recommendations in this study are based on research that includes: prior studies, reviews of National Association of Insurance Commissioners (NAIC) Market Share Reports, Iowa Insurance Division credit based insurance score model filings, public hearing testimony (both at a state level and national level), consumer testimony, Iowa Insurance Division consumer complaints, an Iowa based survey on credit scoring, and an information request submitted to the top auto and home insurance carriers for Iowa in 2008. The limitations of this study should be noted. This study was not performed with the goal of refuting or confirming claims made in prior studies nor does it include an independent multivariate analysis. Though this study seeks to answer the question of how to properly deal with personal lines, the focus of the research and analysis will be on homeowner's and auto policies. Automobile and homeowner's insurance comprise all except for one of the 2008 insurance scoring filings in the state of Iowa.

B. History and Background

For nearly two decades the use of personal credit history in insurance has developed and intensified. The first modern insurance score models became a popular technique for determining loss in the early to mid 1990s.[4] With the growth of insurance scoring use, nearly all property and casualty insurance companies use credit histories in some form to determine the costs of insurance for consumers. Insurers explain that the goal behind insurance scoring is to enhance claims prediction, both in frequency and severity. The insurance industry believes that a low insurance score predicts that a person will file more insurance claims.[5] Consumers with

[3] Iowa Code 515.103 (1) (j) defines personal insurance as "personal insurance and not commercial insurance and is limited to private passenger automobile, homeowners, farm owners, personal farm liability, motorcycle, mobile home owners, noncommercial dwelling fire, boat personal watercraft, snowmobile, and recreational vehicle insurance policies, that are individually underwritten for personal, family, farm, or household use. No other type of insurance is included as personal insurance for the purposes of [use of credit information]."

[4] Federal Trade Commission, *Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance* (A Report to Congress, 2007).

[5] Garry Boulard, *The Roar Over Credit Scores*. State Legislatures. October/November 2004. 19-20.

high insurance scores are given discounts. As opposed to consumers with low insurance scores, who are often given surcharges in relation to how low their insurance score is calculated to be.

C. **<u>How Insurance Scoring Works</u>**

To calculate an insurance score, a consumer's credit report is reviewed.[6] To gain this information an insurance company will have to work with third party vendors, as a credit report is provided only through a credit reporting agency.[7] The factors in a credit report are then translated into a numerical value by an insurance scoring (risk) model (usually a computer program) to produce the insurance score.[8] The risk model itself may be a product owned by a specialized risk evaluation company (an insurance scoring model company) or the insurance company.[9] A copy of an insurance scoring model can be found in Appendix1A.

Credit based insurance scores can be used by insurance companies to screen and group consumers up to three times.[10] The initial screening is done during the underwriting process. When a company first obtains an insurance score, an underwriter may use that score to decide if that individual is eligible for coverage with the company and if so, which of their company's affiliates is best suited for that score.[11] A large company may divide particular groups or ranges of insurance scores into set affiliates, requiring that a consumer's credit score must meet qualifications to receive a policy from a particular affiliate. Once an affiliated company has been selected for a consumer, the insurance score will then be used as a rating factor.[12] As a rating factor, the insurance score will be placed in subgroups of like scores which are assigned to a corresponding tier. Each tiered grouping is given another numerical value which is used in calculations to determine premium.[13] Based on a review of credit models filed with the Iowa Insurance Division, each tier will usually fall into the category of discount, neutral, and surcharge (a subpar grouping below neutral). The values assigned to the tiers are set at the discretion of the companies.

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[6] Iowa Code § 515.103 (1) (g) defines a credit report as "any information related to credit that is contained in or derived from a credit report, or provided in an application for personal insurance."

[7] See Fair Credit Reporting Act, 15 U.S.C. § 1681 *et seq*. (2009).

[8] J. Robert Hunter (Director of Insurance, Consumer Federation of America). *Testimony on The Impact of Credit - Based Insurance Scoring on the Availability and Affordability of Insurance*. Subcommittee on Oversight and Investigations of the Committee on Financial Services. 110th Cong., 1st sess., May 21, 2008.

[9] *How Scoring Works*. FICO. Insurancescore.com, 2007. http://www.insurancescore.com/scoreworks.aspx.

[10] Hunter, *Testimony on The Impact of Credit- Based Insurance Scoring on the Availability and Affordability of Insurance.*

[11] Iowa Code §515.103 (1)(b) defines an affiliate as "any company that controls, is controlled by, or is under common control with another company.

[12] Hunter, *Testimony on The Impact of Credit- Based Insurance Scoring on the Availability and Affordability of Insurance.*

[13] *Ibid.*

D. The Controversial Issues

While accepted as an actuarially sound technique by the insurance industry, many challenge insurance scoring as an inappropriate factor. Some believe it should be banned as a matter of public policy. To prove its legitimacy, demystify its techniques, or to simply better understand its impact on the insurance world, studies have been conducted, literature has been reviewed, and testimonies have been provided by those on both sides of the issue. Though not an exhaustive list, the following is an overview of prevalent issues of controversy for insurance scoring.

1. Causation vs. Correlation

The topic of causation versus correlation is a discussion of legitimacy. The insurance industry points to studies and statistics that show an existence of a statistical correlation between insurance scores and claims propensity. Opponents of insurance scoring believe a correlation is not enough. Opponents deem that causation, a causal link connecting loss propensity and scores, is significant and necessary before legitimacy is accepted.

Causation is defined as "the act or agency which produces an effect".[14] Correlation is "a relation existing between phenomena or things or between mathematical or statistical variables which tend to vary, be associated or occur together in a way not expected on the basis of chance alone."[15] The distinction between causation and correlation is explained by the Statistical Assessment Service (STATS) at George Mason University.[16] STATS explains that a direct action or event can cause another event showing causation. If there is an established causal link (causation), there is a clear correlation, but establishing a correlation is not enough alone to establish a causal link. This is because establishing causation (a causal link) is extremely difficult. The most common way to establish causation is through a controlled study.[17] Controlled studies allow for the elimination of the possibility of any other factors creating a causal link. Correlation, on the other hand, can be established through statistics.[18]

a. Multivariate Analysis Studies on Correlation

The insurance industry has sponsored or produced studies to demonstrate the correlative relationship between insurance scoring and claims. Two of those studies include those by James Monaghan and the actuarial firm of EPIC. In 2000, Casualty Actuarial Society published a study

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[14] Merriam-Webster's Online Dictionary, "Causation". http://www.merriam-webster.com/dictionary/causation.

[15] Merriam-Webster's Online Dictionary, "Correlation". http://www.merriam-webster.com/dictionary/correlation

[16] *What is the Difference Between Causation and Correlation?* Statistical Assessment Service (STATS), George Mason University. http://stats.org/in_depth/faq/causation_correlation.htm.

[17] *Ibid*.

[18] *Ibid*.

by James Monaghan that contained a multivariate analysis on credit history and loss performance.[19] The Academy of Actuaries (Academy), reviewed this study on behalf of the National Association of Insurance Commissioners.[20] Of the variables analyzed by Monaghan, credit history enhanced predictability, independently from other factors. The Academy found that while Monaghan did provide a multivariate analysis, the information was confined to new business (no renewals) and the limited analysis of only two variables for the multivariate analysis, making the study also a bivariate analysis.

In 2003, the insurance industry retained the firm of EPIC to conduct an actuarial analysis on credit based insurance scoring in auto insurance.[21] The study was to address correlation, the degree of overlap of insurance scoring with other risk factors, and the importance of insurance scoring in assessing risk. Like previous studies EPIC agreed that insurance scores provided a correlation to loss propensity, but did not find the same support for claims severity. A level of overlap between insurance scoring and other risk factors were also confirmed. But, in the opinion of EPIC the "result does not change our opinion about the importance of insurance scores as a risk factor, and is consistent with our observation that claim frequency tends to be the main component explaining difference in pure premiums for insurance scores."[22] The importance of insurance scoring in assessing risk varied according to the type of coverage. It was found to be the most important risk assessment factor for personal injury protection or medical payments, but in comprehensive and collision coverage it was third in importance. In its analysis on the subject EPIC acknowledged that insurance scores may not be in the top risk factors for all coverage, but believed that it is still important.

Multivariate analyses have been produced by regulators as well. In a Texas Department of Insurance multivariate analysis, a correlation to claims frequency for both home and auto was found.[23] Claims severity was found to have a statistical correlation to home loss (but not for auto).[24] The Department also found that for auto insurance, credit was not the most important rating factor for predicting claims experience.[25] The Federal Trade Commission (FTC) reported

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[19] James Monaghan, *The Impact of Personal Credit History on Loss Performance in Personal Lines*. Casualty Actuarial Society (Arlington, Virginia 2000: Winter 79). http://www.casact.org/dare/index.cfm?fuseaction=view&abstrID=3154.

[20] *The Use of Credit History for Personal Lines of Insurance: Report to the National Association of Insurance Commissioners*. American Academy of Actuaries, November 2002.

[21] Michael J. Miller and Richard A. Smith, *The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity*. EPIC Actuaries, LLC. June 2003.

[22] *Ibid.* at 37.

[23] Texas Department of Insurance. *Use of Credit Information by Insurers in Texas*. (Supplemental Report to the 79th Legislature).

[24] *Ibid.*

[25] *Ibid.*

on a multivariate analysis in their 2007 report to Congress.[26] Though the conclusions were consistent with other statistical analysis showing correlation, the findings were not unanimously accepted for publication. Three of the FTC Commissioners issued a joint statement regarding their vote to release the study, one Commissioner chose to issue a concurring statement addressing his reasons for support and concerns over the study, and a fifth Commissioner released a statement explaining her dissenting vote regarding the release of the study. Criticism, both internally within the commission and externally focused on the study's data and methodology.[27]

Though correlation has been studied by the insurance industry and some regulators, critics of insurance scoring believe all the studies showing correlation are not enough to explain the inability to show causation.[28] The concern is that with a lack of causation, there is the possibility of too many other factors possibly causing that correlation. The most common factors suggested being race and income.[29]

b. Theories on Causation

The insurance industry points to an article regarding risky behaviors as a possible answer to the causation controversy. In the article *Biological and Psychobehavioral Correlates of Credit Scores and Automobile Insurance Losses: Toward an Explication of Why Credit Scoring Works*, authors Brockett and Golden equate the same characteristics that cause risky financial behavior in an individual, to the characteristics that will cause risky behaviors in other areas of life.[30] According to the study "a biological and behavioral framework established by sensation seeking and biochemical characteristics can be [assumed to] make an individual more willing to accept financial risk".[31] Brockett and Golden's study held that credit scores demonstrate the responsibility and stability of an individual in multiple areas of life.[32] This includes areas of life that are insured such as driving.[33] These risky behavior characteristics presented in the study are suggested as the causal link between insurance scores (measured financial risk) and loss

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[26] FTC, 25-29.

[27] FTC, Dissent, 1-2.

[28] Chi Chi Wu and Birny Birnbaum, *Credit Scoring and Insurance: Costing Consumers Billions and Perpetuating the Economic Racial Divide*. The National Consumer Law Center and the Center for Economic Justice. June 2007.

[29] *Ibid.*

[30] Patrick L. Brockett and Linda Golden, *Biological and Psychobehavioral Correlates of Credit Scores and Automobile Insurance Losses: Toward an Explication of Why Credit Scoring Works*. The Journal of Risk and Insurance 74 (2007): 24.

[31] *Ibid.* at 33

[32] *Ibid.* at 26 (Please note the authors refer to credit scoring instead of insurance scoring, even though insurance is referenced.)

[33] *See Ibid.*

propensity (the risk in other life areas). Brockett and Golden believe that this theory will apply even if other traditional variables are removed from the analysis.[34]

In testimony provided at the NAIC's Hearing on Credit Scoring, Patrick Butler, Director of the National Organization of Women, challenged the findings that risky behavior is linked to low credit scores.[35] Butler suggested an alternative to the theory presented by Brockett and Golden.[36] Butler equated lower credit scores with higher miles driven. He believed that mileage reports match the liability claims from low to high credit score ranges. The more miles driven, the more opportunities a consumer has to get into an accident.[37] Butler suggests this explains the research used by Brockett and Golden.

2. The Impact on Minorities and Accessibility

One of the major concerns expressed by consumer groups regards the effect of insurance scoring on protected classes. These concerns include disproportional representation in lower insurance score ranges and the effects lower insurance scores can have on the affordability of insurance. The evaluation of this issue has been studied heavily by regulators and the courts.

a. Studies by Regulatory Agencies

The 2007 FTC study on credit-based insurance scoring was mandated by Congress to determine if insurance scoring was a proxy for membership in a federally protected class.[38] The protected classes included "race, ethnicity, national origin, geography, income, religion, age, sex and marital status".[39] The analysis conducted by the FTC did discover some proxy in relation to the protected classes of African Americans and Hispanics. These groups were heavily represented in the low insurance score group. Specifically, African Americans and Hispanics represented the lowest quarter and lowest third (respectively) of the insurance score distribution. The FTC concluded that the predictive value of insurance scoring outweighed this proxy affect because insurance scores "do not act solely as a proxy for membership" in a protected group.[40]

Congress also mandated that the FTC comment on the effect insurance scoring has on pricing and availability.[41] The FTC reasoned that as insurance scores create increased accuracy in

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[34] *Ibid.* at 26

[35] Patrick Butler, *Testimony at the NAIC Hearing on Credit Scoring*, *Why Low Credit Scores Predict More Auto Liability Claims: Two Theories.* Journal of Insurance Regulation. October 2007.

[36] Butler at 3.

[37] *Ibid.* at 4.

[38] FTC at 51.

[39] *Ibid.*

[40] Ibid at 72.

[41] FTC at 34.

pricing, the marketplace for insurance would broaden. The FTC did add the caveat that there will always be individuals that get misplaced in a group they do not seem to belong in, no matter the rating model.[42] The FTC explained additionally that insurance scoring should be a “zero sum game” in which those with higher risk pay more and those with lower risk pay less.[43] In researching the possibility that those with lower scores (and therefore higher insurance premiums) would be more likely to drive without insurance, the FTC found this to be true generally.[44] But, a warning was provided that this information should be looked upon with caution because the different insurance laws in the states may alter the conclusions.

As previously noted, the results of the FTC study were criticized. In a dissenting opinion, one Commissioner pointed to the errors and flaws in the methodology.[45] The criticism included records that could not be independently checked and allowing insurers to provide information used for analysis. The Commissioner believed an endorsement of insurance scoring could not be properly made as the study did not provide for a fully informed decision.[46] The Commissioner’s criticism was echoed and added to by consumer groups and some actuaries.[47] Additionally, opponents of credit scoring point out that where companies have used alternatives to insurance scoring the effect has created a less discriminatory affect on protected classes.[48]

In addition to the FTC, state insurance departments have also reviewed the impact of insurance scoring on their minority communities. In Virginia, the state’s Bureau of Insurance performed an analysis based on zip code. The report did not find information that would conclude race or income were a proxy for credit scores.[49] That was not the case with Missouri Department of Insurance. Based on their zip code analysis, it was consistently shown that zip codes with higher minority populations produced the worse insurance scores.[50] The same case was found for income, age, marital status, and education attainment.[51] Of all the factors, race was found to be the most prominent connection and the correlation existed regardless of zip code.[52] Similarly,

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[42] *Ibid.* at 36.

[43] *Ibid.* at 37

[44] *Ibid.* at 41-42.

[45] FTC, Dissent at 2-4.

[46] Ibid at 6.

[47] Birny Birnbaum (Center for Economic Justice). *Testimony at the NAIC Hearing on Credit Scoring*. National Association of Insurance Commissioners. April 30, 2009. Also see Michael J. Miller, *Disparate Impact and Unfairly Discriminatory Insurance Rates.* Casualty Actuarial society E-Forum, Winter 2009.

[48] Wu at 17.

[49] FTC at 51.

[50] See Brent Kabler, *Insurance Based Credit Scores: Impact on Minority and Low Income Populations in Missouri*. The Missouri Department of Insurance, January 2004.

[51] *Ibid.* at 17

[52] *Ibid.* at 11-12.

Texas also conducted research on the impact of insurance scoring on minorities. Relying on individual data (not zip code) Texas found that African American and Hispanic communities again had the lower insurance scores.[53] The state of Alaska prepared a market based study on the effects credit-based insurance scoring would have on the state.[54] Alaska found some indications that there may be unequal effects on ethnic consumers and consumers with lower incomes, but declined to make definitive conclusions on the subject due to the limitations in the information analyzed.

None of the above states have banned insurance scoring regardless of any proxy or disproportionate impact information found. Legislative solutions were sought as the result of the studies, but none of legislatures have passed full insurance score bans. The legislatures instead set in place other provisions and laws. The specifics of the various state prohibitions and bans are discussed in more detail later in the study.

b. Disparate Impact

The effect insurance scoring has had on protected classes has given rise to some litigation regarding disparate impact. Disparate impact is the adverse effect of a practice that appears neutral on a protected class and is found not to be a business necessity.[55] This means a company's practice or a law could say nothing about a protected class and it could appear to treat everyone the same, but when that practice is applied the results are shown to have a negative impact on a protected class. Disparate impact does not require the intention to discriminate in order to cause a violation.

Proponents of insurance scoring have asserted that the actuarial principles used to determine if an insurance practice is unfair is scrutinized at a different standards than those used by disparate impact and other discrimination laws.[56] The industry contends that the applicable principles are "making and rating distinctions 'between individuals or risks of the same class and essentially the same hazard' or "when underwriting and rating decisions are unsupported."[57] Proponents emphasize that making distinctions between risk factors and segmenting groups is at the base of most insurer's pricing programs, therefore allowing for some discrimination.[58] Concerns have

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[53] *Use of Credit Information by Insurers in Texas*. Texas Department of Insurance, December 2004.

[54] *Insurance Credit Scoring in Alaska*. The State of Alaska Department of Community and Economic Development and the Alaska Division of Insurance. February 2003.

[55] Black's Law Dictionary, seventh edition. "disparate impact".

[56] *The Legal Theory of Disparate Impact Does Not Apply to the Regulation of Credit-Based Insurance Scoring, A NAMIC Public Policy Paper*. National Association of Mutual Insurance Companies. July 2004.

[57] *Ibid.* at 18.

[58] *Ibid.*

even included the possibility that if disparate impact is applied to insurance scoring, then there is the opportunity for other insurance risk factors to be found as discriminatory also.[59]

The insurance industry has relied on the application of the McCarren-Ferguson Act. The McCarren-Ferguson Act allows for federal laws, not dealing with insurance to be preempted by state law.[60] But a preemption of federal law is only necessary when the law in question is in conflict with the state law or if it would frustrate an officially articulated state regulatory goal.[61]

When challenged in litigation, some courts have declined to follow the industries concept of discrimination and preemption, but have instead opened the door for the application of federal civil rights laws such as §1981, §1982, and the Fair Housing Act to apply to insurance. Specifically, courts in the fourth, fifth, sixth, seventh, ninth, and eleventh circuits have determined that federal anti-discrimination laws can apply to insurance.[62] The Eleventh Circuit Court of Appeals has even rejected the idea of allowing discriminatory practices based on actuarial reality because the court did not believe that racial discrimination was the intent of the insurance regulation.[63]

The Federal court authority for Iowa falls under the jurisdiction of the Eighth Circuit Court of Appeals. The Eighth Circuit has addressed both the issue of preemption and the application of federal anti-discrimination laws in the 2008 case of *Saunders v. Farmers Insurance Exchange*.[64] The court commented in *Saunders* that federal civil rights laws may be preempted by McCarren-Ferguson Act depending on how the broadly written the civil rights laws were applied.[65] The Eighth Circuit Court in *Saunders* acknowledged that the state in question, Missouri, had delegated the duty of rate-making and reviewing risk classification and pricing differentials to the Director of Insurance.[66] The court held that state laws regarding ratemaking were "essential to the core" of Missouri's regulation of insurance.[67] In reviewing how the petitioners in Saunders wished to apply federal anti-discrimination laws the Eight Circuit Court held that "[if] a federal court may assess damages based upon what a non-discriminatory rate would have been, and then prescribe the future rate in an injunctive decree, 'a more complete overlap with the state agency's pricing decisions is impossible to conceive'. Based on how the anti-discrimination

[59] Michael J. Miller, *Disparate Impact and Unfairly Discriminatory Insurance Rates*. Casualty Actuarial society E-Forum. Winter 2009.

[60] *See Humana Inc. v. Forsyth*, 525 U.S. 299 (1999).

[61] *Dehoyos v. Allstate Corporation*, 345 F.3d 290, 294(5th Cir. 2003).

[62] *Ibid.* at 295.

[63] *Ibid.*

[64] *Saunders v. Farmers Ins. Exchange*, 537 F.3d 961 (8Th Cir. 2008).

[65] *Ibid.* at 967.

[66] *Ibid.* at 968.

[67] *Ibid.* at 967.

laws were requested to be applied in *Saunders*, the Eighth Circuit held that federal law was preempted by the McCarren-Ferguson Act. The court also noted that the State did not provide a means for consumers to seek a private right of action, but instead required the insured to "seek relief from the Director of Insurance, who has exclusive authority to conduct administrative hearings, or to commence an action in state court to remedy an insurer violation and the insured's financial injury" regarding rates.[68] Saunders sets a precedent in Iowa and must be considered when applying federal civil rights laws to insurance for states under the federal Eighth Circuit Court of Appeals jurisdiction, as outcomes and results will likely be based upon the courts findings in Saunders.

The application of federal civil rights laws to insurance has been addressed by the many circuits of the United States appeals courts. The appeals courts are the second highest courts in the nation after the United States Supreme Court. The issue of how anti-discrimination laws are applied in federal courts is not matter resolved nationally, as the appeals courts have created a difference of opinion amongst the many jurisdictions of the circuit courts of appeals. As such, the reconciliation nationally of one definitive direction on how to apply federal civil rights laws to insurance would have to be decided by the United States Supreme Court. Until that time, the area remains unsettled nationally.

3. Other Issues of Note

Opponents of credit-based insurance scoring have raised the issue of acceptability. [69] The major acceptability concerns raised on actuarial principles are that a risk classification system should be "based upon clearly relevant data, should respect personal privacy, and they should be structured so that the risks tend to indentify naturally with their classification".[70] Opponents contend that insurance scoring has problems meeting this expectation. Some of the reasons included: all three credit bureaus have different reports and numbers, credit reports vary according to the time of the month, credit scores focus on types of credit used as much as the payment record, paying with cash is penalized, and lenders may not fully report information to the credit bureaus. [71] Insurance scoring opponents' acceptability objections extend to the accuracy of credit reports. Opponents point to Federal Reserve research discussing accuracy problems found in credit reports. The Federal Reserve has found that key aspects of the data collected may be ambiguous, duplicate, or incomplete. The Federal Reserve also points out that reporting is not mandatory for creditors.

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[68] *Ibid.* at 968.

[69] J. Robert Hunter, *Testimony at the NAIC April 30th, Public Fact-Finding Hearing on the Use of Credit -Based Insurance Scores*. National Association of Insurance Commissioners. April 2009.

[70] *Ibid.*

[71] J. Robert Hunter, *Testimony at the NAIC April 30th, Public Fact-Finding Hearing on the Use of Credit -Based Insurance Scores*.

On the issue of state creation of rules and laws dealing with credit-based insurance scoring versus the Fair Credit Reporting Act (FCRA), the insurance industry has expressed that FCRA, as amended, allows insurers to use credit information. [72] Specifically, FCRA allows for credit reporting agencies to share credit reports with insurers when used for underwriting purposes and unlike anti-discrimination laws, the FCRA speaks specifically to insurance.[73] Case law on this subject has provided clarification when dealing with FCRA and state statutes. In an Eighth Circuit Court of Appeals case, *Davenport v. Farmers Insurance Group*, the court found "State law is pre-empted by FCRA only when compliance with inconsistent [s]tate law would result in violation of FCRA."[74] In this vein federal courts have held that as long as the state statute is consistent with Congress' goal of consumer protection, the states may add additional protections and remedies for consumers to state law.[75]

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[72] *The Legal Theory of Disparate Impact Does Not Apply to the Regulation of Credit-Based Insurance Scoring,* at 12.

[73] 15 U.S.C. § 1681a.

[74] *Davenport v. Farmers Insurance Group*, 378 F.3d 843 (8th Cir. 2004).

[75] *Credit Data of Arizona, Inc. v. State of Arizona*, 602 F.2d 195 (9th Cir. 1979).

II. Insurance Scoring Laws

Credit reports and credit history used by insurers must meet compliance with various laws providing guidance on the matter. On the federal level the FCRA stipulates requirements for those who access and use credit reporting information. On the state level, some consistency can be seen with the National Conference of Insurance Legislators (NCOIL) model act language on the use of credit information in personal insurance lines. Though some states have decided to use the NCOIL model law language, variations on that law can be found among the states. Other states have declined to use the NCOIL model altogether.

A. The Fair Credit Reporting Act

The FCRA is a federal law that is enforced by the Federal Trade Commission (FTC). The FCRA places requirements and guidelines on those organizations that share and receive credit history reports.[76] Originally enacted in the 1970s the act has been amended numerous times and most recently in 2009. In establishing FCRA Congress found that Credit Reporting Agencies (CRAs) played a vital role in data collection which is accessed by various areas of commerce.[77] One of the areas of commerce allowed to receive credit reports from the CRAs is insurance. Once insurers access credit reports for underwriting purposes, those insurers are required to follow the consumer protections in the FCRA. Some of the requirements in the FCRA can be seen in the insurance scoring laws of the states as an influencing factor.

One such area of influence can been seen in the state enacted versions of the fair credit reporting acts. Another area is in the notice of adverse action requirements. Under the FCRA, insurance adverse actions are defined as a denial, cancellation, increase in any charge, or reduction or unfavorable change in coverage terms for insurance in connection to the underwriting of insurance. The FCRA adds to the general definition any action or determination that is adverse to the consumer's interest due to a consumer's review of their own credit history for personal review. The definition of adverse action covers both existing policies on renewal and prospective coverage.

The FCRA provides requirements for credit report users that take adverse action against consumers based on their credit information. Consumers that have experienced credit-based adverse action must be provided with notification of the adverse action taken against them. Consumers must also be provided with the contact information of the CRA that furnished the credit report. A copy of the credit report must be provided (for up to 60 days) for free as well as the disclosure of the rights of consumers under the FCRA.

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[76] *The Fair Credit Reporting Act,* Federal Trade Commission (2009). http://www.ftc.gov/os/statutes/fcrajump.shtm.

[77] Fair Credit Reporting Act, 15 U.S.C. § 1681 *et seq*. (2009).

The right to dispute credit report information is found in the FCRA, but is frequently referred to in state insurance scoring laws. Consumers have a right to accurate and complete credit reports and when necessary, consumers may challenge the accuracy and completeness of their credit report with the CRA. Challenged credit information will be noted as such on the credit reports issued by the CRA until the conclusion of the dispute investigation.

B. Iowa Law

In 2002 the NCOIL created a national model act regarding the use of personal credit history in personal insurance.[78] Since that time the model has been incorporated in whole or in part by nearly half the states including Iowa. Iowa's current insurance scoring law has been in place since 2004 and can be found under Iowa Code § 515.103. The Iowa law incorporates the NCOIL model. There are no differences between the model act and Iowa law except for the provision dealing with consumers with an absence of credit or an inability to calculate and the definitions section. Under the NCOIL model act, an insurer may rate a consumer with an absence of credit or an inability to calculate an insurance score in a manner approved by the Insurance Departments. This provision is not present in Iowa's statute. [79] Iowa law also has an expanded definition section that is more detailed then the model act and includes definitions of "insured" and "personal insurance".[80]

The Iowa law is comprised of multiple sections.[81] Language is provided to define the scope of the law.[82] The Iowa law limits its reach to personal insurance. Personal insurance is defined as "private passenger automobile, homeowners, farm owners, personal farm liability, motorcycle, mobile home owners, noncommercial dwelling fire, boat, personal watercraft, snowmobile, and recreational vehicle insurance policies, that are individually underwritten for personal, family, farm, or household use." [83] Key prohibitions for using credit history in insurance are also addressed.[84] Income, gender, address, zip code, ethnic group, religion, marital status, or nationality may not be used in insurance scoring calculations. Excluded from being used in calculations are insurance inquiries, medical collection accounts, credit inquires not initiated by the consumer, inquires initiated by a consumer to obtain their own credit information (as also

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[78] National Conference of Insurance Regulators, *A Letter to Regulators.* April 28, 2009.

[79] Iowa Code § 515.103; National Conference of Insurance Regulators, *Bill Summary of An NCOIL Model Act Regarding Use of Credit Information in Personal Insurance*. 2007. http://www.ncoil.org/Docs/BillSummaryofCSMl.pdf.

[80] Iowa Code § 515.103.

[81] *Ibid*.

[82] *Ibid*.

[83] *Ibid.*

[84] *Ibid*.

prohibited under FCRA), and using multiple leader inquires in the areas of auto or mortgage lending. It is permissible to count all lender inquires once per type of loan, but the inquiries must be made within a 30 day time span.

An insurer is prohibited from solely basing a decision to deny, cancel, refuse to renew, or rerate a policy on credit information. Adverse actions based on not having a credit card account are also prohibited if it is the sole factor. For consumers that lack credit history or have credit history files so small there is an inability to calculate an insurance score, insurers must: 1) treat the consumer neutral as defined by the insurer, or 2) exclude credit history as an underwriting factor.[85] Credit reports used to calculate insurance scores are prohibited from being over 90 days old and an insurer must recalculate an insurance score every three years. A provision is also provided for consumers (or their agents) to request annually a recalculation of new rates and underwriting based on current history.

The extraordinary life circumstances amendment was added to the NCOIL model in 2009 to specifically address the economic challenges currently faced by consumers.[86] In 2010 the extraordinary life exception circumstances amendment was added to Iowa law.[87] As amended, insurers are required to consider an exception to using credit information influenced by any stipulated event. While the language allows an insurer to make an exception to any event they choose, required events include disaster (as declared by the government), serious illness or injury, death, divorce, involuntary interruption of legally owed alimony or support payments, identity theft, involuntary temporary loss of employment over three months, and military deployment.

There are additional consumer protections found in Iowa's law.[88] An insurer is required to rerate and re-underwrite a policy that has used disputed information found to be incorrect under a FCRA investigation. Insurers are to refund the consumer any overpayment that is discovered as the result of the corrected credit report. An insurer must also disclose to consumers that a credit report may be requested during the policy application process. An insurer is only required to make this disclosure once and it is not required at the time of renewal. In addition, insurers must follow the notification requirements provided in the FCRA and provide the consumer with the top four reasons why an adverse action has been taken.

The last sections of the statute provide technical guidelines for insurers. Insurers are required to file insurance scoring models with the Commissioner of Insurance and may include loss

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[85] Iowa Code § 515.103.

[86] National Conference of Insurance Regulators, *A Letter to Regulators.*

[87] Iowa Code § 515.103.

[88] *Ibid.*

experience as justification for using credit information.[89] Insurance scoring models are held as confidential and are not considered subject to public information laws. The remaining provisions include an indemnity clause, a severability clause, and a prohibition on the resale of insurance inquiry information by credit reporting agencies excepted to those who made the original request.

As previously stated Iowa law closely follows the NCOIL model. Therefore for the purposes of this study, the statutory analysis for Iowa should be considered also an analysis of the NCOIL act because of the similarities (except as otherwise noted).

C. State Insurance Scoring Laws

The NCOIL model act language has been accepted wholly or in pieces by enacting states. Some changes to model language encompass modifications to the standardized language used by the model law or added provisions. The states that have incorporated all, some portion, or similar language to the NCOIL model act include: Alabama, Arkansas, Colorado, Florida, Georgia, Indiana, Illinois, Iowa, Kansas, Louisiana, Maine, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, New York, North Dakota, Oklahoma, Tennessee, Texas, and Virginia.

Among the different insurance scoring laws are three jurisdictions that have chosen not to legislate on the issue of insurance scoring: Pennsylvania, Vermont, and the District of Columbia. The state of South Dakota has chosen to address the use of credit information by providing insurance department guidelines instead of legislation. For those states that have addressed the use of credit history in personal lines, the laws vary among the states. A summary of the laws and guidelines for all states was used for the following analysis and can be found in Appendix 2A.

An insurance scoring provision that can be found in some states is the extraordinary life circumstance exception provision. The life exceptions states (at the time of this study) include Montana, Florida, Delaware, Rhode Island, Minnesota, New Mexico, Texas, Iowa, Connecticut and Virginia. Most life exception provisions, excluding the one found in the NCOIL model, allow an opportunity for consumer's to have a covered life event removed from consideration in the calculation of that consumer's insurance score. The NCOIL model does not specify what treatment to provide to consumers with life exceptions. The exception events listed in the NCOIL model can be found in most state extraordinary life exceptions provisions.

State insurance scoring laws also differ in the area of prohibitions. Some insurance scoring prohibitions have attempted to address discrimination. West Virginia and Delaware prohibit insurance scoring based on disability. In Nevada, discrimination is addressed by prohibiting invidious discrimination. Likewise, Georgia does not allow underwriting that creates fictitious groups that lead to unfair discrimination.

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[89] *Ibid*.

Most states specifically provide protections to avoid discriminating against consumers with an inability to calculate an insurance score or where there is an absence of credit history (commonly referred to as no hits / no scores) similar to the NCOIL model. But, in the state of New Mexico insurers must treat consumers with no hits or no scores as average, better than average or exclude credit history completely. The Alaska statute states no hits or no scores consumers be treated as neutral as defined by the Alaska Insurance Commissioner. Specifically, the Alaska Insurance Commissioner's guidelines for neutral provided for allowing no hits / no score consumers to be eligible for the best rates if the consumer's positive risk factors would allow for qualification, using additional criteria in place of credit, or allowing an insurer to demonstrate that a neutral placement is the same placement a consumer would receive without the use of credit. In Delaware, an insurer may consider that a consumer has no hits or no scores for their underwriting and rating as long as the insurer demonstrates the placement is justified. Delaware's requirement for justification is very broad and states only that information should be sufficient for the Commissioner to make a determination. Lastly, in Alabama consumers 55 years of age or older with no hits / no score files must be treated as having the best credit unless the insurer can prove otherwise.

States also address restrictions on insurance score calculations differently. Many states differ to the NCOIL Model Act in this matter. But the states of Alaska, Arizona, Colorado, Delaware, Indiana, Louisiana, Maryland, Missouri, Montana, Ohio and Wisconsin have provided for additional or different calculation restrictions. The provisions are generally the result of addressing issues that have arisen in that particular state. Some of the prohibitions are eligible for waiver if the factor is found to be actuarially justified. The scoring prohibited factors variations include:

- Age of person when credit was established (AK)
- Most recent auto and home loans obtained (AK)
- Any credit history based off of medical history (AK/IN)
- Bankruptcies or liens over 7 years old (AZ)
- Items on a report over a set number of years old (DE/MD)
- Identity theft (AZ)
- The use of a particular type of credit card (AZ/ MT/WI)
- Dissolution or marriage, or the credit information of a former spouse (CO)
- Credit report information that is disputed (DE/MO/OH)
- Credit report information if the use will lead to adverse action (VA)
- A consumer's total available line of credit (AZ/DE/MT/OR/VA/WI)
- Promotional inquiries, periodic inquiries by existing credit providers, or credit system administration inquiries (LA)

States have made efforts to increase transparency and consumer knowledge in regards to insurance scoring. In Kansas, when a premium changes, insurers are required to provide consumers with each reason that contributed to the change. Consumer information is increased with additional disclosure requirements in New York when insurers must provide insurance scoring disclosures at both the initial issuing of the insurance policy and also at subsequent renewals. In South Carolina, the consumers' credit reports are kept on file for three years by the insurers. This is done so consumers may accurately inspect their credit report files. Similarly, consumers are able to review insurance scoring models in the state of Texas. Though considered trade secret by most states, Texas considers insurance scoring models to be public information. Washington also provides an opportunity for insurers to make their insurance scoring models public, if desired. In addition, Washington provides for consumers to receive detailed information from insurers about insurance scoring. Specifically, insurers are required to provide information that aids consumers to understand why a higher premium has been charged and what consumer can do to change identified adverse attributes. Insurers in Washington must file with the Commissioner a copy of any industry studies relied upon to justify a company's use of insurance scoring, so it is accessible by the public.

1. Restrictions on Renewals

A select number of states have placed restrictions on the use of insurance scoring on renewal policies. Theses polices had the use of insurance scoring during the initial underwriting and rating of a policy, but upon renewal were subject to guidelines on how insurance scoring is permitted to influence the changes in pricing and placement. This type of restriction is found in Alaska, Connecticut, Delaware, Oregon, Maryland (for auto insurance only), New York, Pennsylvania, and Utah (for auto insurance only).

The renewal restrictions usually take the form of permitting the use of insurance scoring on renewals only if it will improve the standing of the consumer and will not act as a detriment in any way. Basically this means that the use of insurance scoring after the initial underwriting and rating may only be used to benefit the consumer if credit history is reevaluated. The insurance score, the affiliate placement, the tier, and the rating factor used in the initial rating is still permitted to be used, but cannot be changed in a way that would adversely impact a consumer if an insurance score is reevaluated. If a score is not reevaluated, the insurance score can become a stagnant factor used in calculating a premium. All the states that follow this type of restriction on renewal allow for the consumer to request a reevaluation of their insurance score. In the states of Utah and New York, an insurance company may also reevaluate credit information without the request of the consumer.

Alaska is different from other states that place restrictions on renewals. Alaska will permit a consumer's credit history to be used for the initial policy. Upon renewal, the credit history or insurance score information used previously must be removed completely and may not be considered in any way. The only exception to this law is if the consumer requests in writing to waive this restriction.

There are some states that have no specific law or regulation that deal with restricting the use of insurance scoring on renewals, but have reached a similar effect through other department policies. The state of Pennsylvania requires prior approval of rates by Insurance Department.[90] As of the time of this report there have been no approved rate filings for renewal polices.

The insurance departments of Delaware, Oregon, Maryland, New York, Pennsylvania, and Utah were contacted via the departments' actuarial or consumer services divisions. The departments were all asked about noticeable effects caused by the change in insurance scoring policy to the rates or insurer participation in the market. None of the departments reported noticeable changes at that time.

2. Bans

Insurance score bans are in place for the state of California, Hawaii, Massachusetts, and Maryland. California banned insurance scoring for auto insurance in the 1980s. This was done with proposition 103 and applies to auto insurance. While California has not banned insurance scoring for homeowners insurance, it is a prior approval state for rates. As of the time of this report, no filing has been approved for use in California's homeowner's policies.[91] Hawaii likewise passed its insurance scoring ban decades ago. In the 1970s Hawaii went through massive statutory change for auto insurance.[92] The ban has continued since that time for auto insurance, but homeowner policies are permitted to use insurance scoring. Maryland banned insurance scoring for homeowner's insurance. The state of Maryland enacted its latest insurance scoring laws in October of 2002 and the ban encompassed both new and renewal policies. [93] Similarly, insurance scoring is not allowed to used for personal passage auto insurance in Massachusetts.

The actuarial departments for the states of California, Hawaii, and Maryland were asked if any derogatory effects were found after the enactment of the bans. California and Hawaii confirmed that as their bans have been in place for decades, no information could be provided on the subject. Maryland, whose insurance ban began less than a decade ago, confirmed that rates have increased since that time. However, it cannot confirm that the insurance scoring ban was the cause of the increased rates.

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[90] Information provided by the Pennsylvania Insurance Department, Office of Insurance Product Regulation and Administration.

[91] Information provided by the California Department of Insurance, Rate Regulation Branch.

[92] Information provided by the Hawaii Department of Insurance, Insurance Rate and Policy Branch.

[93] Use of Credit History for Underwriting and Rating, Bulletin 02-14. Maryland Insurance Administration. June 2002.

3. Unique Provisions

There are provisions that are unique to a single state. Arkansas law is faithful to the NCOIL model act, but requires companies to track and report the number of policies that increase and decrease due to credit information. This report is provided to the Insurance Department. Idaho's unique provision limits the numerical weight permitted to be assigned to insurance scoring. Under Idaho law, an insurer is prohibited from "primarily" basing a premium on credit history. Idaho defines primarily based as the weight of the credit history factors not exceeding the weight of all the noncredit based factors combined. The law applies to both new and renewal business. While most states permit an insurer to have their credit information re-evaluated once a year, the state of Minnesota permits their consumers to request reevaluation twice a year.

III. Insurance Scoring in Iowa

A. Insurance Company Information Request

To provide a better understanding of how insurance scoring policies are affecting Iowans, information was requested from the top ten Iowa insurers based on market share for homeowner's and auto insurance in 2008. The information request contained five questions. The questions pertained to the number of Iowans affected by insurance scoring and how those Iowans were affected by the use insurance scoring. Information was additionally provided on pricing in regards to insurance scoring. The information request sent to the applicable insurers is available for review in Appendix 3A. Results from the sampled insurers are as provided.

1. Participation

The top ten insurers for auto and homeowner's insurance in Iowa represented 50.03% of the auto insurance market and 66.81% of the homeowner's market. The total market share provided from the participating insurers was reduced due to Nationwide Mutual Insurance and Owner's Insurance declining to provide information at the time of analysis. Results for American Family Insurance are also not included as the information reported did not lend itself to be reconciled with the other reporting companies. But, in addition to the top ten market share companies, USAA Insurance volunteered information in homeowner's insurance, which has been included. As shown in Exhibit A, the final market share percentage represented was 40.83% for auto and 50.03% for homeowner's insurance.

Exhibit A:

Auto

Company	M.S. %
State Farm Mutual	15.28%
Progressive Northern	6.97%
Farm Bureau	6.07%
American Family	5.38%
Nationwide Agribusiness	4.07%
Nationwide Mutual	3.83%
Grinnell Mutual	2.70%
Progressive Universal	2.36%
Grinnell Select Insurance	1.72%
State Farm Fire	1.66%
Total Requested:	**50.04%**
American Family	(5.38%)
Nationwide Mutual	(3.83%)
Total Participation:	**40.83%**

Home

Company	M.S. %
State Farm Fire	25.85%
AMCO	8.35%
American Family	8.26%
Farm Bureau	7.04%
Depositors	6.16%
IMT	2.85%
Owners Insurance	2.41%
West Bend	2.19%
Farmers	1.99%
Allied P&C	1.71%
Total Requested:	**67.74%**
American Family	(8.26%)
Owners Insurance	(2.41%)
USAA Home	0.93%
Total Participation:	**50.03%**

2. Policy Distributions

The participating insurers reported a total of 820,364 auto policies and 404,966 homeowner's policies were in-force during 2008. While all the participating insurers in the top ten use credit-based insurance scoring, the practice was not applied to all of the participating insurers' policies in 2008. The reasons provided were some grandfathered policies were not subject to insurance scoring. Also, some of the renewal policies no longer used insurance scoring. The policies that were subject to insurance scoring totaled 432,500 automobile policies and 230,085 homeowner's insurance policies.

Based upon the insurers reported definition of neutral, all the policies affected by insurance scoring were broken into categories of discount, neutral, and subpar (a below neutral score). The distribution is provided in Exhibits B and C.

Exhibit B:

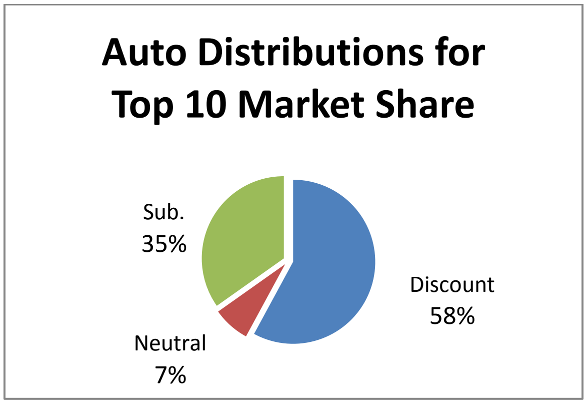
Auto

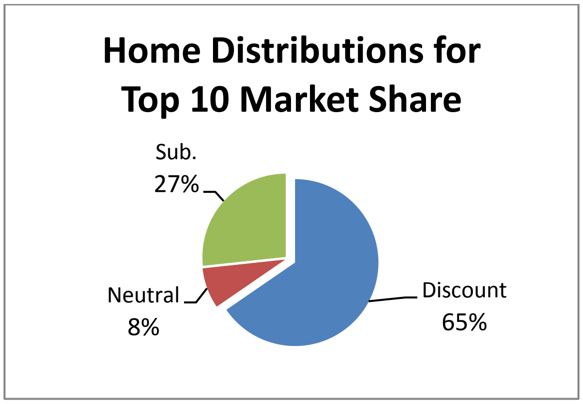
Discount	Neutral	Subpar
250,466	31,563	150,471

Homeowners

Discount	Neutral	Subpar
150,532	18,131	61,422

Exhibit C:





The combined totals for home and auto policies receiving discounted pricing was 400,998 policies, while 211,893 policies received subpar pricing. Three of the insurers treat their subpar polices as receiving no discount or surcharge. All other subpar policies (146,647 total policies) are given a surcharge for falling below the neutral insurance scoring tier.

3. Neutral

Under Iowa law, insurers assign neutral insurance scores to consumers with an absence of credit or consumers whose credit history is too small to calculate a score. [94] These consumers are referred to as no hits / no scores. No hits / no scores consumers are a diversified group. Candidates for no hits / no scores can include the consumers who have not developed their credit, consumers who are established enough financially to have paid all outstanding debt and have no need to use credit, or are consumers who have made the lifestyle choice of paying for items with cash instead of credit. Iowa law also allows insurers to create their own definition of neutral. The law does not place any formal guidelines or justification requirements for a company's definition of neutral. This means that Iowans can be subjected to hundreds of inconsistent definitions of neutral if the definition of no hits / no scores applies to them.

The information request asked companies to provide their definition of neutral. The response was widely varied. There were companies that chose to define neutral closer to the insurance scores receiving more of discount (leaving more subpar tiers) or near the middle of the range of rating tiers (creating nearly an equal amount of discount and subpar tiers). Still some insurers chose to assign consumers towards the bottom of the rating tiers. One insurer even placed consumers with no scores at the very bottom rating tier, giving those consumers the same insurance scoring tier as the most expensive subpar tier. An example of the different ways neutral is handled is generalized in Exhibit D.

Exhibit D[95]:

Company A:

Tier	S/N/D	Differential	Premium
Tier 1	Discount	0.7	$ 70.00
Tier 2	Discount	0.75	$ 75.00
Tier 3	Discount	0.8	$ 80.00
Tier 4	Discount	0.85	$ 85.00
Tier 5	Discount	0.9	$ 90.00
Tier 6	Discount	0.95	$ 95.00
Tier 7	Neutral	1	$ 100.00
Tier 8	Subpar	1.08	$ 108.00
Tier 9	Subpar	1.15	$ 115.00
Tier 10	Subpar	1.21	$ 121.00
Tier 11	Subpar	1.27	$ 127.00
Tier 12	Subpar	1.35	$ 135.00
Tier 13	Subpar	2	$ 200.00

Company B:

Tier	S/N/D	Differential	Premium
Tier 1	Discount	0.8	$ 80.00
Tier 2	Discount	0.82	$ 82.00
Tier 3	Discount	0.84	$ 84.00
Tier 4	Discount	0.86	$ 86.00
Tier 5	Discount	0.88	$ 88.00
Tier 6	Discount	0.9	$ 90.00
Tier 7	Discount	0.92	$ 92.00
Tier 8	Discount	0.94	$ 94.00
Tier 9	Discount	0.96	$ 96.00
Tier 10	Discount	0.98	$ 98.00
Tier 11	Neutral	1	$ 100.00
Tier 12	Subpar	1.5	$ 150.00
Tier 13	Subpar	2	$ 200.00

Company C:

Tier	S/N/D	Differential	Premium
Tier 1	Discount	0.7	$ 70.00
Tier 2	Neutral	0.75	$ 75.00
Tier 3	Subpar	1.15	$ 115.00
Tier 4	Subpar	1.17	$ 117.00
Tier 5	Subpar	1.19	$ 119.00
Tier 6	Subpar	1.2	$ 120.00
Tier 7	Subpar	1.25	$ 125.00
Tier 8	Subpar	1.3	$ 130.00
Tier 9	Subpar	1.35	$ 135.00
Tier 10	Subpar	1.4	$ 140.00
Tier 11	Subpar	1.45	$ 145.00
Tier 12	Subpar	1.5	$ 150.00
Tier 13	Subpar	2	$ 200.00

[94] Iowa Code § 515.103(2)(e)

[95] A base rate of $100 was used for all premiums in the exhibit.

Though insurers create their own definition of neutral for no hits / no scores, the results of the information request revealed that companies internally can produce inconsistencies. When asked to price a hypothetical no hits / no score consumer (which it is supposed to receive neutral treatment), three companies placed the hypothetical consumer differently from where the companies' definitions of neutral would have placed the consumer. When calculated based upon the prices provided for the hypothetical consumer, this inconsistency created a difference in the total numbers of consumers receiving discounts or subpar rates. Basing the tier distributions on pricing practices, the number of discounted policies decreased by 14,714 and subpar polices increased by 17,889.

Review of the company information also revealed that some insurers are rating incorrectly. Under Iowa law there are separate standards for rating and underwriting no hits / no scores consumers. While the standard for rating is neutral treatment, the standard for underwriting is to eliminate credit information as considered criteria and instead only consider other underwriting factors. While the underwriting standard allows an insurer to decide if they wish to insure a consumer and to decide which affiliate to place them with, this guideline has a different affect on rating. When applied to rating, consumers with no hits / no scores can individually be placed in the most expensive insurance scoring tier. The confusion of rating standards with underwriting standards has historically been a rate filing problem for companies in Iowa.

4. Pricing Disparities

Using a common hypothetical consumer, the insurers were asked to provide a premium for each of their company's insurance scoring tiers. Seven auto and nine homeowner's insurers provided the premium information for the hypothetical. The hypothetical demonstrated the different prices a consumer could pay for auto and homeowners insurance within a company, when all other factors are the same except for insurance scoring.

Analysis of the information provided demonstrates a marked disparity in the prices paid by a consumer receiving a discount and the consumer receiving subpar prices. Generally looking at all the companies (as a consumer might when shopping for insurance), the consumer with a low insurance score could be offered prices that are three times as high as the cheapest price. In reviewing individual company data, where the sole differing factor in price is the insurance score, the disparity still exists. Some of the comparisons are as follows:

- Lowest Price (Discounted Tier) vs. Highest Price (a Subpar Tier):

Auto

Lowest Difference	Highest Difference
$ 263.37	$ 583.00

Home

Lowest Difference	Highest Difference
$ 250.00	$ 1349.00

- Most Expensive Price with a Discount vs. Lowest Subpar Price:

Auto

Lowest Difference	Highest Difference
$ 2	$ 57.00

Home

Lowest Difference	Highest Difference
$ 4.00	$299.00

- Highest Price with a Discount vs. Highest Price (a Subpar Tier):

Auto

Lowest Difference	Highest Difference
$ 192.00	$ 453.00

Home

Lowest Difference	Highest Difference
$ 205.00	$ 1177.00

Disparities are present in insurance scoring. This is due to insurance scoring being a "zero sum game" as described by the FTC. [96] This means the discounts that are provided to consumers are compensated for in surcharges to achieve the "zero sum game" for a company's use of insurance scoring. The data analysis for Iowa shows the consumers that receive discounts are larger than the number of consumers in the subpar pricing group. As there are fewer consumers in the subpar group to share in offsetting the insurance scoring discounts, the amount of the surcharges are going to be larger than the discounts. This is necessary in order to compensate or pay for all the discounts dispensed to the consumers with better scores. The company information showing a large disparity between the discounted and subpar prices, therefore demonstrates the mechanics of insurance scoring.

5. Rates

Information was sought in questions three and four of the information request to try to calculate the possible impact a change in insurance scoring law could cause. It was decided that this information could not be calculated with certainty, as any possible rating or pricing effects a law change could cause, would require a large number of limiting assumptions and caveats. Due to the lack of certainty, this information is not presented.

B. <u>Consumer Data</u>

Consumer's thoughts, concerns, and opinions on the subject of insurance scoring were reviewed to better understand how this topic was affecting consumers. Testimony was solicited from Iowa consumers for six months, from May 2009 – October 2009. Consumers were given three different mediums to share their testimony: written, verbal, and in person. The written and

[96] FTC at 34.

verbal testimonies were received directly by the Consumer Advocate. The in person testimony was provided at one of the three public hearings held. This information was combined with the first five years worth of consumer complaints regarding insurance scoring received over the period of 2004-2008.

1. Public Hearings

Public statements were permitted to be given at all three public hearings held on May 30, June 29, and September 16, 2009. All hearings were held in Des Moines at the Iowa State Capitol Building. The events were publicized through press releases for all three events, internet posting of the dates and times, newspaper and radio interviews, a live internet chat, and by informing every consumer who contacted the Division about insurance scoring of their right to participate in the public hearing. To make the public hearings accessible to the most consumers, the days and times that conflicted the least with traditional working hours were chosen. Detailed minutes of each of the three hearings can be found in Appendix 3B.

The public hearings produced a mixture of consumer, industry, and interested party testimony. Presenters were present at all three public hearings to provide clarification on specific topics or policies. The first public hearing had a presentation by the Division's property casualty Actuarial Administrator. One of Actuarial Administrator's duties at the Divisions is to review the rates (which include insurance scores) of the insurance companies authorized to do property and casualty business in the state of Iowa. The Actuarial Administrator presented an overview of how insurance scoring presently works in Iowa. The presentation included the definition of insurance scoring under Iowa law and clarified for the public that insurance scores in Iowa are regulated by the Fair Credit Reporting Act and Iowa Code sections 515.103, 515.4, 515.5, and 515.24. Additionally, it was explained by the Actuarial Administrator that the factors of income, gender, address, zip code, ethnic group, religion, marital status, race, and nationality are not permitted to be used for calculating an insurance score. Finally, the Actuarial Administrator further explained that the amount assigned to each calculated insurance score is combined with other rating factors to produce a premium amount. A copy of the Division's Actuarial Administrator's presentation can be found in the May 30, 2009 public hearing minutes in Appendix 3B.

A presentation from an insurance scoring model company, FICO Scoring Solutions was provided during the public hearings. Insurance scoring model companies or vendors as they are often referred to, sell insurance scoring models and insurance scoring calculation services to insurance companies. While some insurers may choose to produce their own insurance scoring models and calculations, the hiring of insurance scoring companies is a service used by many insurers. A summary of FICO's presentation is provided below:

- FICO presented information on what FICO as an insurance scoring model company reviews to calculate insurance scores. To calculate an insurance score five areas of credit information are considered predictive: payment history (40%), outstanding debt (30%), credit history length (15%), pursuit of new credit (10%), and the mixture of credit on the report (5%).
- FICO explained the insurance scoring model companies have no contact with consumers and that FICO does not produce the actual credit report. This is obtained from a CRA.
- FICO asserted that race is not a factor used in insurance scoring.
- FICO's position is that insurance scores remain an effective tool during current difficult economic conditions because FICO's scoring numbers have remained stable. FICO stated that scores may decline for those consumers with financial hardships, but that it is not possible for FICO to generalize on the topic due to the interrelationship between all credit information used to produce a score.
- FICO explained that credit based insurance scores are different from credit risk scores because they are built to predict different things.
- FICO made recommendations on ways for consumers to improve their insurance scores. This information included: making on time payments to creditors and lenders, maintain low credit card balances, open new lines of credit only when necessary, and obtain and review a free credit report annually.

A copy of FICO's presentation and submitted documentation can be found in Appendix 3B under the June 29, 2009 hearing minutes.

In addition to presentations, testimony was given at all three hearings. Testimony was presented from the Executive Director of the Center for Economic Justice (CEJ) during the third public hearing. CEJ is a nonprofit "advocacy and education center dedicated to representing the interest of low-income and minority consumers" on economic justice and equality issues.[97] One of the economic focus areas of the CEJ is insurance and specifically the use of insurance scoring.[98] A summary of the CEJ's presented testimony is provided below:

- It is the CEJ's position that insurance scoring is inherently unfair because it penalizes victims of medical and economic catastrophes as studies have shown that these factors are major contributors to bankruptcies (bankruptcies maybe considered in insurance scoring).
- The CEJ questions the actuarial soundness of insurance scoring. One of the main factors cited for this concern is the inconsistencies found in credit reporting.

[97] The Center for Economic Justice, *Who Are We.* 2011. http://www.cej-online.org/whoweare.php

[98] The Center for Economic Justice, Homepage. 2011. http://www.cej-online.org/creditscoringmainpage.htm

- The insurance scoring bans made in other states (CA, HI, MD) were cited by the CEJ as examples of why insurance scoring is not necessary in a state. The CEJ hypothesized that an insurance scoring ban will not raise the premiums in the state of Iowa because Iowa has a low population density (reducing the likelihood of accidents and claims).
- The CEJ disagrees with the Insurance Industries position that insurance scores are predictive of losses. The CEJ stated that the statistical relationship between insurance scores and loss is not sufficient. The CEJ also emphasized that the purpose of insurance is to pool risk not predict risk.
- The CEJ expressed concerns about that the NCOIL Model (the basis for Iowa law). In the opinion of the CEJ the NCOIL model fails to provide meaningful disclosures and prohibitions against unreasonable behavior towards consumers.

A written copy of the CEJ's presentation testimony can be found in the September 16, 2009, hearing minutes in Appendix 3B.

A representative from the Property Casualty Insurers Association of America (PCI) spoke on behalf of the insurance industry. PCI is a national trade association that represents over 1,000 member insurance companies.[99] PCI did not give a formal presentation, but did make some comments on behalf of the property and casualty insurance industry. The PCI representative testified that the insurance industry uses insurance scoring because studies have showed that insurance scores provide an increased accuracy of claims predictability. The PCI representative explained that insurance scores are calculated and used by different companies in different ways. PCI also reiterated that insurance scores are just one factor used in calculating premiums.

As part of the testimony provided in the second public hearing, FICO and Transunion LLC participated in a question and answer session. In addition to being a credit scoring model company, Transunion also services as one of the three main CRAs in the nation (along with Equifax and Experian). CRAs are the sources of creditor and lender data collection. The CRAs then in turn produce and share credit reports on individuals. In response to the questions presented during the public hearing, Transunion and FICO provided the following responses (the information is provided in more detail in Appendix 3B):

- Transunion does not hold their insurance scoring models to be trade secrets, and makes them available where permissible. States under the NCOIL model act, like Iowa, must treat scoring models as trade secrets by law and do not provide allowances for public models.
- A example of the interaction between the many companies involved in insurance scoring is as follows: CRAs sends credit reports (from Transunion, Equifax, Experian) →to insurance scoring model companies (example: FICO) that create an insurance score

[99] Property Casualty Insurers Association of America, Homepage. 2010. http://www.pciaa.net/web/sitehome.nsf/main

number that is sent to → insurance companies that incorporate the insurance score into the underwriting and rating for a consumer. Insurance scoring information is shared with consumer and if there is a complaint regarding the contents of a credit report the insurer sends the consumer → to the credit reporting agency for questions and issues with credit. Mr. Boyd and Mr. Rosenberg verified that was correct.

- Transunion explained that as a credit reporting agency, consumers can contact his company if there are questions about the content of the credit report.
- Transunion shared that Transunion will share with consumers ways to improve their scores if asked to do so by the consumer. FICO shares consumer education information on FICO's website.

In addition to the testimony provided by CEJ, PCI, FICO, and Transunion, consumer testimony was provided over the course of all three public hearings. A compilation of the consumer testimony and comments as provided at the public hearings is provided below. Consumers testifying at the hearing shared:

- concerns that credit history was being preferred over claims history. Specifically in situations where consumers had filed no claims, but still received an increased premium due to a lower insurance score;
- concerns at having a lower credit score as the result of all debt being paid off and not pursuing additional lines of credit;
- concerns that consideration should be given to consumers who experience financial hardships like loss of job;
- concerns that while monthly balances on credit cards are paid off, consumers can still be considered to have too many credit cards and therefore considered more likely to file an insurance claim by insurance companies;
- concerns were expressed regarding the logic behind the assumptions behind insurance scoring;
- concerns over the inability to obtain information on what is considered ideal in order to obtain a better insurance score. It was expressed that if consumers are subjected to the insurance scoring process, consumers should receive full disclosure on how scores were calculated and what could be done to improve them;
- concern was expressed over using cash for all purchases and being told a lack of credit would make a consumer ineligible from receiving the best rate.
- concerns that as Iowa has minimum liability laws for auto insurance there should be efforts made to make insurance affordable, not more expensive through insurance scoring;
- Support for insurance scoring as a whole, but acknowledgement that there are problems that can be addressed.

Additional information provided from the consumers as a group during the first public hearing expressed concerns about the difficulty experienced in attempting to gain understanding and answers to questions when the insurance companies and credit reporting agencies were contacted. All consumer comments, as well as the written testimony submitted by consumers can be found in public hearing minutes found in Appendix 3B.

2. Testimony & Complaints

The review of the public testimony received from consumers and the complaint records filed with the Division from 2004 through 2008 have provided some trends in consumer concerns. All accumulated consumer information can be found for review in Appendix 3C. The overall number of consumers submitting complaints or testimony was 63. Of those 63 consumers, a total of 36 consumers submitted testimony on insurance scoring directly to the Insurance Consumer Advocate in 2009. Of the 63 consumer statements, two consumers showed support of the current insurance scoring laws. The rest were opposed to the practice or took issue with a specific aspect of the insurance scoring. The most predominate trend identified from the consumer statements regarded policy renewals. Sixty-eight percent of the consumers complained or testified to having insurance scoring issues related to increased renewal rates.

The specific concerns expressed about insurance scoring can be grouped into three broad categories: causation, fairness in relation to a consumer’s economic situation, and transparency. The largest number of concerns were expressed in the category of fairness in relation to a consumer’s economic situation from 58.7% of the consumers. Consumers expressed that insurance scores were not truly reflective of their financial situation or their individual risk. Consumers’ statements included those who had lost jobs or businesses, faced other dramatic lifestyle changes, were victims of identity theft, or were lower income. As a result of these events, the consumers’ credit information was negatively affected. The consumers expressed that they felt punished by their insurance companies for facing difficulties in life. Some of the consumers also expressed concerns that the increased insurance rates would force difficult decisions on what bills to pay when resources were limited.

Other consumers in this category felt that insurance scoring was unfair in regards to their economic situation because they were good managers of their financial resources. This included consumers who had decided:

- to pay off or refinance larger loans on items like homes,
- consumers who used and paid off credit cards monthly, and
- consumers who refused to use credit and instead used cash for purchases.

The consumers maintained that their bills were regularly paid and on time, therefore demonstrating their good financial responsibility. Consumers disagreed that declining to maintain credit balances or shopping around for a reduced loan amounts (the thereby decreasing monthly bills) was a sign of risky behavior. Nor did consumers feel this warranted an increase in insurance premiums.

The causal connection between credit history and insurance scoring was the next largest area of concern for consumers at 36.5%. Consumers disagreed that credit history truly had anything to do with the level of risk they represented. This included consumers who expressed concerns about causation even after having the concept, theory, and reasoning explained to them at the public hearing by industry representatives.

The issue of transparency was the third general category of concern at 15.8% of consumers. Under Iowa law the algorithms or mathematical equations used to calculate an insurance score is considered confidential.[100] This includes details of what credit history items are used, what weight is given to each item, and what number of any particular credit history item is considered to be the most positive in a particular model. Consumer concerns in this area focused on an inability to know what can be done by a consumer to improve their insurance score. Consumers urged insurance scoring models be made available to the public.

Also worth note is that the Division has received complaints from consumers concerning the use of insurance scores as the sole reason for increasing premiums. Consumers that receive an increase in insurance premiums may receive these increases due to multiple factors and insurance scoring may be one factor combined in with the others. Though an increase in insurance premium may be due to a change in insurance scoring only, Iowa law will permit the increase in premium as long as there is at least one other factor combined to calculate the premium.

The Division has seen the practice of increasing premiums solely due to a change in insurance score reported in Iowa through complaints. The subject has also been investigated by the Market Regulation and Enforcement Bureaus of the Division. One consumer in this situation had an increase of over $600 for the year. Though the company had increased the base rate (the minimal rate for all insured in an areas) for all consumers in Iowa, the company stated the majority of the increase was due to a change in insurance score.

The issue of privacy also appears multiple times when the consumer statements are reviewed. Consumers expressed concerns about being unable to acquire insurance without revealing a social security number, which is used to access a consumer's credit report. Consumers also expressed concerns and disagreement over personal credit information being used in yet another area of life. As a whole, consumers when given this opportunity to express their opinions or make statements on the use of insurance scoring highlighted some concerns that are being faced at a national level (e.g. tough economic times, causation, and transparency) as well as Iowa.

[100] Iowa Code § 515.103

C. St. Ambrose University Report

To supplement the public hearings held in central Iowa, additional information was needed from across the state in order to obtain a broader and more representative sample of Iowans. To accomplish this, St. Ambrose University conducted an opinion and knowledge survey on behalf of the Iowa Insurance Division. The survey was also analyzed and incorporated into a St. Ambrose University authored report. [101] The survey and report are available in Appendix 3D.

1. The Iowa Consumer Survey Results

The Iowa consumer survey, commissioned by the Insurance Division, was based on Iowa's demographics to best provide a representative sample of consumers. Based on the reported survey results, 1,240 surveys were completed. The survey's margin of error is + or - 2.6%, with a confidence level of 95%. As explained by St. Ambrose a 95% confidence level means the authors of the survey are 95% confident that results obtained in the survey would be the same if taken as a census from all Iowans.

The information goals of the survey were to discover: 1) if consumers realize credit history was a factor used in insurance, 2) the general opinion of the consumers on the subject of insurance scoring and did consumers support its use, and lastly 3) is Iowa facing a disproportionate impact in the minority population of Iowa regarding insurance scoring. To determine if consumers found to be consistent in their answers, the survey questions were often asked more than once, in different ways.

The question of consumer knowledge regarding the basic elements of insurance scoring is found in five survey questions. Three of the questions dealt with credit and risk generally, while two questions focused on consumer understanding of rating factors. In regards to risk, about half of the consumers admitted to obtaining credit reports. But, when asked about the indicator behind credit information (and given six choices), the majority of the respondents answered that credit information indicated risk. Other questions highlighting the understanding of rating factors gave respondents six factors to rank in order of importance, according to what they believed to is the most important and what was actually important in determining insurance premiums. Both questions found respondents ranking credit second to last in importance, placing it one above the option of "other". When asked a related question to knowledge, respondents were questioned if their insurance agent had ever shared information about the effects of insurance scoring on rates. The majority of respondents answered no with 88% of the responses.

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[101] Patrick O'Leary, Thomas Quinlan, and Randall Richards, *Use of Credit Scores by the Insurance Industry: Iowa Consumers' Perspective*. (Davenport, St. Ambrose University, 2009).

In a similar line of questioning, consumers were asked about the predictive power of credit-based insurance scoring. The ability for insurance scoring to predict claims is a major reason provided to support the practice. When asked two questions to see if consumers believed in the predictive power of credit as a rating factor, the majority of respondents did not agree it was predictive. First in a multiple choice answer where two of the six answers alluded to predictability, it achieved only about half of the responses (when both answered were combined). The second question asked directly if credit information was predictive of insurance claims, only 14% of the respondents agreed. The majority of respondents did not find credit-based insurance scoring to be predictive.

Nine questions were asked on the survey about the fairness of the practice of insurance scoring. Of the majority of questions asked on this topic, all but one response favored the answer that insurance scoring was unfair as the highest response. On questions that directly mentioned credit in relation to buying or paying for insurance, the results were consistently high ranging from 63% - 78% for the response of unfair. Question 13 was the only fairness question in which consumers responded highest to the practice of using insurance scoring as fair. The question asked if "people with a higher likelihood of filing an insurance claim should pay higher premiums." Though the highest response was for fair, only 46% chose this answer, while 54% either disagreed that the statement was fair or responded as neutral. Except for the one question (which did not represent 50%), respondents did not find the use of credit – based insurance scoring to be fair.

One set of questions presented in the survey queried consumers who chose not to file insurance claims and why. These questions were to address the likelihood of a respondents choosing to self-insure repairs. The results showed that most respondents filed their homeowner's claims when acquiring damage on their homes. For auto insurance, the responses were split with a total of 549 respondents answering that a claim had not been filed after an accident. Half of the respondents that declined to file a claim chose to pay the expense out of pocket. When the researchers calculated the price paid for out of pocket for claims, they found that the average costs of the repairs (around $ 400) were usually less than a $500. The results also show that 141 went without repairs. It is not known from the results if consumers chose to go without repairs or if they could not afford to repair their vehicle.

The final question sought to be answered by the Iowa survey regarded disproportionate impacts on Iowa minorities. Respondents were asked if they had ever received an adverse action letter. Sixty respondents answered yes. Of those respondents only three were minorities. The sample size was found to be too small to provide conclusive testing on the issue.

Disproportionate numbers were found for age and income group. The age group of 25-34 was found to receive a disproportionate amount of adverse action letters. The median age in Iowa is

38 year old.[102] The income level of $ 40,000 - $ 59,999 was also found to receive a disproportionate amount of adverse action notices. This is the same income group in which Iowa's median income can be found for 2008, at $ 49,000.[103]

2. St. Ambrose University's Analysis

Upon completion of the survey, St. Ambrose University authored a report with analysis on the data found in the survey. The University sought to answer four questions:

1) Do Iowans believe that credit scores are valid predictors of risky behavior and insurance claims?
2) What do Iowans know about credit scores generally?
3) Do Iowans believe that using credit scores to determine insurance eligibility and rates is fair?
4) Do minorities receive a disproportionate share of "adverse action" letters from insurers?

In the first question the University found that the consumer opinions on predictability were at odds with industry studies on insurance scoring because respondents did not believe in its claims predictability. The University concluded that the research and multivariate analysis on insurance scoring found in such studies as the 2003 EPIC study, the Texas Department of Insurance Study, and the FTC study, serve as support for predictability. The University concluded that respondent opinion on predictability was due to a lack of education on insurance scoring.

In research question two, the University addressed the knowledge level of respondents. Analysis of the responses showed that consumers were accessing credit information 40% of the time. The University found this to be higher than previous studies by the General Accounting Office on the subject that showed a third of the consumers obtained credit information. The authors also believed that respondents were incorrectly equating risk with an ability to pay due to responses on the reasons for credit information. The University concluded that consumers did not understand this concept and believe this signified a general lack of understanding regarding "the fundamentals of insurance rate setting is lacking."

Though the results of the survey showed consumers found insurance scoring an unfair practice the authors did not necessarily find this information conclusive. After examining the concept of fairness, the University concluded that respondent's idea of fairness is influenced by personal perspective and bias. It was concluded that fairness might be changeable for the respondents depending on if the issue applied to the respondent or not. The University concluded that respondents would be more likely to find an issue fair if it did not apply to them. The University

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[102] Iowa Data Center, *Iowa Quick Facts.* http://www.iowadatacenter.org/browse/quickfacts/?searchterm=average%20age

[103] Iowa Workforce Development, *Iowa Trends, Iowa Economy*. ttp://www.iowaworkforce.org/trends/mediania.html

found that unfair responses provided by the survey again demonstrated that consumers do not understand importance of some insurance concepts like spreading risk.

As previously mentioned the sample size for the response involving disproportionate impact on minorities was too small for conclusive testing. But the University concluded there was no evidence within their study to suggest disproportionate impact. Regarding recommendations based on their analysis, the University encouraged insurance scoring to be looked at as a process that is impartial and produces fair results most of the time. The University recommended establishing mechanisms to deal with situations in which the process may not be fair to consumers. Education on both insurance and credit was also recommended.

IV. Findings

A. Defining the Best Policy for Iowa

To determine the best insurance scoring policy for Iowa, the information reviewed must be analyzed and multiple factors must be considered. The most basic consideration is consumer protection. There are three provisions under Iowa Law central to consumer protection on insurance scoring: the general powers and authority of the Commissioner, the rate filing practices and requirements, and the provisions regarding consumer advocacy. [104] Combined, these areas of the law make consumer protection a duty and responsibility for the Commissioner of Insurance.

Fairness is another consideration in determining the best policy for insurance scoring in Iowa. As insurance scoring provides a benefit for some consumers and not others, the question of fairness is harder to define. The company data from the information request showed that over 400,000 of the sampled consumers received a discount from insurance scoring. But nearly 150,000 consumers were reported to be subject to surcharges. The consumers who pay more for insurance will not (and do not according to consumers' comments) find this practice fair. Removing insurance scoring from rating and underwriting may cause the consumers obtaining a discount to receive increased prices. The discounted consumers will not find this fair. The dynamic between these two sets of consumers create the crux of the problem for insurance scoring, as there is no win-win situation available for all of Iowa's consumers. There is also no definitive data for Iowa to show the costs consumers would face if insurance scoring were removed. As the Commissioner of Insurance serves both of the consumer groups who do and do not receive a discount, the fairness of all consumers must be considered.

Consideration must also be given to the factors that make Iowa unique. Iowa's auto and homeowner's insurance markets are competitive and stable. Based on market analysis performed by the National Association of Insurance Commissioners (NAIC), Iowa maintained the lowest premiums in the nation in auto insurance for the last ten years of record.[105]

The NAIC additionally provided information on homeowner's insurance showing that Iowa has remained in the ten least expensive states for homeowner's insurance for that period. The low price Iowa consumers have continuously paid for their insurance (compared to the rest of the nation), produces a consumer interest in maintaining low rates as much as possible. Therefore, the best policy for Iowa should: 1) provide consumer protection and consideration for all the consumers the Commissioner serves and 2) maintain the low rates Iowa has enjoyed over the past decade.

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[104] Iowa Code § 505.8(1); Iowa Code § 515.F; Iowa Code § 505.8(6)

[105] Based on the National Association of Insurance Commissioners Auto Insurance Data Base from 2004 and 2008.

B. Findings of the Study

1. Though no conclusions of disproportionate impact were found in the Iowa Consumer Survey, other regulators have discovered disproportionate impacts to minorities and low income consumers.

The controversial issues raised nationally on insurance scoring underline some unintended consequences of the practice. Three regulatory agencies (Texas, Missouri, and the FTC) found disproportionate impacts on minorities or low income consumers. The FTC also found that insurance scoring could affect the affordability of insurance for consumers affected by a disproportionate impact.

The authors of the Iowa consumer survey did not find a disproportionate impact on minorities in Iowa based on survey information. No conclusions should be made on this issue for Iowa, due to that lack of an appropriate sample size. But, the findings of the other regulatory agencies should cause the Division to remain conscious that disproportionate impact has been found in other states. It should also be remembered that the Iowa survey did find a disproportionate impact for income and age.

2. Iowa law lacks meaningful guidance in some areas for insurers.

The first area where meaningful guidance is lacking is on filing requirements. The law states that an insurer may submit loss experience for justification on an insurance scoring model.[106] As the insurance industry asserts the legitimacy of insurance scoring, this information must available to the companies for review. The fact that so little support supportive information is required to be shared with insurance regulators to support the legitimacy of the use of insurance scoring, is a flaw in the Iowa law model.

The insurance company data submitted as part of the information request provided additional areas of concern. Highlighted by the information request was the lack of meaningful guidance under Iowa's insurance scoring laws for no hits / no score consumers. Insurers are to treat no hits / no score consumers as neutral. The information request shows inconsistencies and problems caused by allowing each insurer to create its own definition of "neutral" under Iowa law. The insurance company data submitted has also demonstrated that some insurers have inaccurately applied underwriting guidelines instead of Iowa's rating standards when self-defining neutral. The submitted data has even demonstrated that some insurers have failed to correctly apply their own definition of neutral to their own pricing practices. The results leave no hits / no scores consumers to be treated more or less fairly according to what company they

[106] Iowa Code § 515.103(6)(a)

are with due to the insurer defined “neutral”. The neutral treatment of consumers with no hits / no scores is supposed to be a consumer protection under Iowa law. As it is applied now, that protection is flawed as it provides too much opportunity for manipulation and error by insurers.

3. An insurance score alone can cause a dramatic range in premiums prices.

The mechanics of insurance scoring creates disparities in pricing. The disparities are created when insurers compensate for the large number of policy holders receiving the discount versus the smaller number of policy holders available to receive surcharges. However, each insurer decides how large the pricing disparity will be among their company’s policies. The company data for Iowa illustrated the difference in premium ranges facing consumers based solely on insurance scoring. Some companies reported a smaller range of prices, but other companies demonstrated how extreme the differences in prices can be. One price range was reported to be over $1349.00 in difference. The variety of pricing options from the reporting companies’ information showed that consumers can comparison shop and save substantially on their insurance prices.

4. Iowans are facing more unexpected life changes in the current economy.

Consumers consistently revealed concerns about their treatment when facing unexpected financial hardships or tough economic times. Nearly 60% of the consumers who chose to make statements or filed complaints expressed their frustration at being penalized by their insurers for facing hardships outside of their control. This is expected as Iowa has not been immune from the national economic recession. In looking at statistics for Iowa (found in Appendix 4A), the unemployment rate nearly doubled from 2007 to 2009 and has remained over 6% since 2009.

5. Pricing increases at the time of renewal motivate most complaints.

Nearly 70% of the consumer data showed problems with insurance scoring during renewals, making it the largest trend in the consumer data and an issue to be addressed. Renewal price increases due to insurance scoring are usually unexpected. This is an extra expense that can hinder the affordability and accessibility of insurance. As an increase in price can be caused by a change in an insurance score alone, consumers have found insurance scoring at the time of renewal even more difficult to accept. Iowa law prohibits renewal rates from being based solely on “credit information, without consideration of any other applicable underwriting factors independent of credit information that are not otherwise prohibited.” [107] Though the language under Iowa law may appear to protect consumers, the prohibition is an illusory protection as rates are not comprised of one factor alone. Under current Iowa laws, as long as a premium is

[107] Iowa Code 515.103(2)(c)

not based solely on insurance score, a change in insurance score alone can cause a rate increase (because there are still other rating factors present within the rate). An increase in rates, based on current Iowa law, can be based on a change to one factor, including if that one factor is insurance scoring. This finding also gives consideration to the fact the application and interpretation of the "solely" language has also been a problem in Iowa as evidenced by past investigations by the Division.

6. Consumer concern about the inability to obtain information on how to specifically improve their insurance score is legitimate.

The formulas, calculations, and factor weights or values used to determine a score are treated as trade secrets and are not made available to the public. Consumers are left to guess at what actions are needed to improve their insurance score. Based on consumer complaints and testimony, some attempts to guess ways to increase their insurance score can instead cause more harm than benefit because the guesses were incorrect. Consumers have a right to know how to improve their insurance scores and in turn the price they pay for insurance.

7. The Iowa consumer opinion survey showed respondents did not find insurance scoring to be fair. Respondents also failed to understand the importance of monitoring and maintaining credit in current times.

Based on the survey, a clear majority of respondents did not find the use of credit information in insurance to be a fair practice. Another decisive response showed consumers are not receiving education information on effects of insurance scoring. However, there is no requirement under Iowa law to provide insurance scoring education. The only information required by law is in a disclosure. Iowa's insurance scoring disclosures are minimal and vague. Insurers meet disclosure requirements by informing consumers that an insurer may "review your credit report" or may "use a credit-based insurance score" based on the report information.[108] This is not descriptive or conducive to educating consumers on the practice of insurance scoring.

The Iowa consumer survey responses regarding obtaining and reviewing credit information were low. Forty-two percent of the respondents had not reviewed their credit report. Personal credit is used in many areas of modern life including insurance. If only 58% of the survey respondents have ever obtained a credit report (which is free annually), the respondents clearly do not realize the importance of knowing and monitoring their own personal credit information. If more consumers knew more about insurance scoring, respondents would have additional motivation to obtain credit reports.

[108] Iowa Code § 515.103(4)(b)

C. Recommendations

The following changes are recommended to address concerns and achieve the best policy for Iowa regarding insurance scoring.

1. Require any recalculation of insurance scores upon renewal be to the benefit of the consumer and never a detriment.

Guidelines are needed for insurers regarding insurance scoring practices at the time of renewal. Insurers should only be allowed to use insurance scoring at renewal if it will not cause any adverse action or cause any rating or underwriting changes that do not benefit the consumer. Consumers, producers, and insurers may maintain their current right and ability to have an insurance score recalculated. For insurers this is at a time that is consistent with their procedures and at minimum every three years. For consumers or their producers on their behalf, this is annually. If a recalculation should result in a better standing for the consumer, based on the standards established for the initial policy, an improvement shall is required.

While some consumers may have expressed disagreement with insurance scoring as a whole, pursuant to this study, most of the specific consumer comments from the public hearings, testimony, and complaints revolve around insurance scoring at the time of renewal. Implementing this recommendation will allow for a significant improvement for Iowans, as most consumers choose an initial policy at a price they are satisfied with from among their options. This recommendation will also eliminate problems caused by the term "solely" under current law, as renewal increases will no longer be caused by insurance scoring.

Placing guidelines on the use of insurance scoring at the time of renewal will provide a middle ground for the divergent group of consumers the Commissioner of Insurance has the duty to serve and protect. Consumer fairness will receive a middle ground that could potentially benefit both consumers with and without insurance score discounts. Consumers who receive a discount will maintain their discount. But, consumers that do not receive the best priced insurance scoring category are given the opportunity to improve and reduce the pricing disparities.

- States with similar practices: Delaware, Oregon, Maryland (auto only), New York, and Utah (auto only), Connecticut
- Legislation required: Yes

2. Provide insurers with additional guidance in filing rates and defining neutral treatment.

The insurance scoring statute needs to be amended to provide additional rate filing guidelines and to allow the Commissioner of Insurance to define neutral. There is too much inconsistency and room for error with the current laws on neutral treatment. Also, as insurance scoring is one of the most controversial issues in property and casualty insurance, insurers should elaborate on the reasons for its use and legitimacy for Iowans. This recommendation would provide the additional guidance needed to protect consumers and provide consistency.

- States with similar practices: Alaska (neutral), Delaware (filing guidance), New York (filing guidance), and Indiana (filing guidance)
- Legislation Required: Yes

3. Increase the transparency of insurance scoring by requiring additional notices and disclosures to consumers.

Consumers need to understand insurance scoring is being used, how it is used, and how their personal insurance score can be improved in order to decrease insurance premiums. To achieve the goal of increased understanding and knowledge, insurers need to communicate to consumers clearly in consumer friendly disclosures: that insurance scoring will be used, an explanation of insurance scoring, what credit information is used and in what order, the right to a extraordinary life circumstance exception from premium increases, and the contact information of the credit reporting agency used. For consumers who receive adverse action notification, an insurer needs to inform the consumer specifically of ways to improve their insurance score, aiding consumers that wish to decrease their premium. Additionally, all insurance scoring models are considered confidential currently under Iowa law, even if the company filing the scoring model does not hold it to be so. Iowa law should be changed to permit insurance scoring models to be public information if so desired by the filing party.

- States with similar practices: Washington, New Mexico, and New York
- Legislation Required: Yes

4. Increase consumer understanding on the importance of credit information through outreach.

Education and outreach are needed to complement the disclosures and notices sent by insurers. Consumers need to understand the importance of monitoring and maintaining good and accurate credit information, for insurance as well as in many other significant areas of life. The Iowa consumer survey has showed a lack of attentiveness to credit report information. To overcome this apathy the Division should increase its education outreach efforts regarding credit. Currently the Division is a member of a coalition which provides financial literacy called Jumpstart. The findings of the Iowa consumer survey should be shared with Jumpstart in order to encourage additional emphasis on credit monitoring during their outreach efforts. In addition to the national Jumpstart program, a new credit based outreach should be initiated to educate consumers on why credit information is important and that credit information may be used in unexpected areas of life (such as insurance). It is also recommended that the Division work with other state agencies whose consumers are also affected by credit report information (i.e., Division of Banking, Credit Union Division, and Iowa Workforce Development). The outreach could be offered to the public in general or to a specific targeted group, such as college students who are just establishing their credit history.

- States with similar practices: Nationally (Jumpstart) and Massachusetts (project credit smarts)
- Legislation Required: No

D. <u>Suggested Language Changes to Iowa Code § 515.103</u>

515.103 Use of credit information — personal insurance.515.103 Use of credit information — personal insurance.

1. Definitions. As used in this section unless the context otherwise requires:

a . "Adverse action" means a denial of issuance, cancellation, or refusal to renew, an increase in any charge for, or a reduction or other unfavorable change in the terms of coverage or amount of any personal insurance existing or applied for, or in connection with the underwriting of personal insurance.

b . "Affiliate" means any company that controls, is controlled by, or is under common control with another company.

c . "Applicant" means an individual who has applied to be covered by a personal insurance policy with an insurer.

d . "Consumer" means an insured whose credit information is used or whose insurance score is calculated in the underwriting or rating of a personal insurance policy or an applicant for such a personal insurance policy.

e . "Consumer reporting agency" means any person that, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information concerning consumers for the purpose of furnishing consumer credit reports to third parties.

f . "Credit information" means any information related to credit that is contained in or derived from a credit report, or provided in an application for personal insurance. Information that is not related to credit shall not be considered "credit information" regardless of whether the information is contained in or derived from a credit report or an application for credit or is used to calculate an insurance score.

g . "Credit report" means any written, oral, or other communication of information by a consumer reporting agency that relates to a consumer's creditworthiness, credit standing, or credit capacity and that is used or expected to be used or is collected, in whole or in part, for the purpose of serving as a factor in determining personal insurance premiums, eligibility for personal insurance coverage, <u>placement within a particular affiliate,</u> or tier placement.

h . "Insurance score" means a number or rating that is derived from an algorithm, computer application, model, or other process that is based in whole or in part on credit information for the purposes of predicting the future insurance loss exposure of a consumer.

i . “Insured” means an individual who is covered by a personal insurance policy.

j . “Personal insurance” means personal insurance and not commercial insurance and is limited to private passenger automobile, homeowners, farm owners, personal farm liability, motorcycle, mobile home owners, noncommercial dwelling fire, boat, personal watercraft, snowmobile, and recreational vehicle insurance policies, that are individually underwritten for personal, family, farm, or household use. No other type of insurance is included as personal insurance for the purposes of this section .

2. Use of credit information. An insurer authorized to do business in Iowa that uses credit information to underwrite or rate risks for a policy of personal insurance shall not do any of the following:

a . Use an insurance score that is calculated using income, gender, address, zip code, ethnic group, religion, marital status, race, or nationality of a consumer as a factor.

b . Deny issuance, cancel, or refuse to renew a policy of personal insurance solely on the basis of credit information, without consideration of any other applicable underwriting factors independent of credit information that are not otherwise prohibited under paragraph “a” .

c . ~~Base a consumer’s renewal rates for personal insurance solely on the basis of credit information, without consideration of any other applicable underwriting factors independent of credit information that are not otherwise prohibited under paragraph “a” .~~

Assign a consumer at renewal to a less favorable rating category or premium for a policy of personal insurance based in whole or in part on the consumer’s credit history or insurance score. The insurer may recalculate a consumer’s insurance score according to the standards that the insurer used initially for the policy, if it is to the consumer’s benefit.

d . Take adverse action against a consumer solely because the consumer does not have a credit card account, without consideration of any other applicable underwriting factors independent of credit information that are not otherwise prohibited under paragraph “a” .

e . Consider an absence of credit information or an inability to calculate an insurance score in underwriting or rating personal insurance unless the insurer does one of the following:

(1) ~~Treats~~ Rate the consumer as if the consumer has neutral credit information, as defined by the ~~insurer~~ Commissioner of Insurance.

(2) ~~Excludes~~ <u>Underwrite by excluding</u> the use of credit information as an underwriting factor and only uses other underwriting criteria.

f . Take adverse action against a consumer based on credit information, unless the insurer obtains and uses a credit report issued or an insurance score calculated within ninety days before the date a personal insurance policy is first written or a renewal is issued.

g . Use credit information unless not later than every thirty-six months following the last time that the insurer obtained current credit information for the insured, the insurer recalculates the insurance score or obtains an updated credit report for the insured. Regardless of the requirements of this paragraph:

(1) At annual renewal, upon the request of the consumer or the consumer's agent, the insurer shall re-underwrite and re-rate the personal insurance policy based upon a current credit report or insurance score. <u>New credit information shall be used consistently with paragraph "c".</u> An insurer is not required to recalculate an insurance score or obtain a current credit report more than once in a twelve-month period.

(2) The insurer shall have the discretion to obtain current credit information for a consumer more frequently than every thirty-six months, if consistent with the insurer's underwriting guidelines.

(3) Notwithstanding subparagraph (1), an insurer is not required to obtain current credit information for a consumer if any of the following applies:

(a) The insurer is treating the consumer as otherwise approved by the commissioner of insurance.

(b) The consumer is in the most favorably priced tier of the insurer, within a group of affiliated insurers. However, the insurer shall have the discretion to obtain current credit information, if consistent with the insurer's underwriting guidelines.

(c) Credit information was not used for underwriting or rating the insured when the personal insurance policy was initially written. However, the insurer shall have the discretion to use current credit information for underwriting or rating the insured upon renewal of the policy, if consistent with the insurer's underwriting guidelines.

(d) The insurer reevaluates the insured beginning no later than thirty-six months after the personal insurance policy was initially written and thereafter, based on other underwriting or rating factors, excluding credit information.

h . Use any of the following as a negative factor in any insurance scoring methodology or in reviewing credit information for the purpose of underwriting or rating a personal insurance policy:

(1) Credit inquiries not initiated by the consumer or inquiries requested by the consumer for the consumer's own credit information.

(2) Inquiries relating to insurance coverage, if so identified on a consumer's credit report.

(3) Collection accounts with a medical industry code, if so identified on a consumer's credit report.

(4) Multiple lender inquiries, if coded by a consumer reporting agency on the consumer's credit report as being from the home mortgage industry and made within thirty days of one another, unless only one inquiry is considered.

(5) Multiple lender inquiries, if coded by a consumer reporting agency on the consumer's credit report as being from the automobile lending industry and made within thirty days of one another, unless only one inquiry is considered.

3. Dispute resolution and error correction. Notwithstanding the prohibitions of section 2, ~~I~~if it is determined through the dispute resolution process set forth under the federal Fair Credit Reporting Act, 15 U.S.C. § 1681i(a)(5), that the credit information of a current insured is incorrect or incomplete and the insurer receives notice of such determination from either the consumer reporting agency or from the insured, the insurer shall re-underwrite and re-rate the insured within thirty days of receiving the notice. After re-underwriting or re-rating the insured, the insurer shall make any adjustments necessary, consistent with the insurer's underwriting and rating guidelines. If an insurer determines that an insured has overpaid the premium on a personal insurance policy, the insurer shall refund the amount of the overpayment to the insured, calculated for either the last twelve months of coverage or the actual policy period, whichever is shorter.

4. Initial notification.

a . If an insurer writing personal insurance uses credit information in underwriting or rating a consumer, the insurer or the insurer's agent shall disclose, either on the insurance application or at the time that the insurance application is taken, that the insurer may obtain credit information of the consumer in connection with the application. Such disclosure to a consumer shall either be written or provided in the same medium as the application for insurance. An insurer is not required to provide the disclosure statement required under this subsection to a consumer in connection with the renewal of a personal insurance policy if the consumer has previously been provided with such a disclosure statement.

b . An insurer that uses ~~the following statement of disclosure shall be deemed to be in compliance with this subsection~~ credit information shall in clear and specific language, comply with the following disclosures:

~~In connection with this application for insurance, we may review your credit report or obtain or use a credit-based insurance score based on the information contained in that credit report. We may use a third party in connection with the development of your insurance score.~~

(1) inform the consumer that credit information will be obtained and used in connection with the application or renewal,
(2) provide a clear explanation of insurance scoring and how credit information is used by the insurer,
(3) list items within the consumer's credit information used by the insurer that will be considered in the rating of the consumer's policy and the order of importance of that information,
(4) provide an explanation of insurers extraordinary life circumstances procedures, and
(5) provide the name and contact information of the consumer reporting agency supplying the credit information used in determining the score.

5. Notification of adverse action. If an insurer takes adverse action against a consumer based on credit information, the insurer shall do all of the following:

a . Provide notification to the consumer that adverse action has been taken, in accordance with the requirements of the federal Fair Credit Reporting Act, 15 U.S.C. § 1681m(a).

b . Provide notification to the consumer explaining the reasons for the adverse action taken. Such notice shall give reasons for the adverse action taken in language that is sufficiently clear and specific so that a person can identify the basis for the insurer's decision to take adverse action. Such notification shall include a description of up to four factors that were the primary influences for the adverse action taken. The use of generalized terms such as "poor credit history", "poor credit rating", or "poor insurance score" does not meet the explanation requirements of this paragraph. ~~Standardized credit explanations that are provided by consumer reporting agencies or other third-party vendors are deemed to comply with this paragraph.~~

c. Provide information that helps the consumer determine why the consumer was charged a higher premium or determined to be ineligible for coverage by the insurer. The information must include with the reasons for the adverse action:

(1) a description of the attributes of the credit history that adversely affected the consumers' insurance score or placement for coverage with the insurer;

(2) how the attribute of credit history affect the insurance score;

(3) any actions that are available to the consumer that may improve this attribute of the insurance score; and

(4) if an insurer refers a consumer to insurance industry research or studies to justify the effect of an insurance score on premiums or eligibility for coverage, the insurer must file those studies with the Commissioner of Insurance so they are available for the public to reference.

6. Extraordinary life circumstances.

a . An insurer authorized to do business in Iowa that uses credit information to underwrite or rate risks for a policy of personal insurance shall, on written request from a consumer, provide reasonable exceptions to the insurer's rates, rating classifications, company or tier placement, or underwriting rules or guidelines for a consumer who has experienced and whose credit information has been directly influenced by any of the following events:

(1) Catastrophic event, as declared by the federal or a state government.

(2) Serious illness or injury, or serious illness or injury to an immediate family member.

(3) Death of a spouse, child, or parent.

(4) Divorce or involuntary interruption of legally owed alimony or support payments.

(5) Identity theft.

(6) Temporary loss of employment for a period of three months or more, if such loss results from involuntary termination of employment.

(7) Military deployment overseas.

(8) Other events, as determined by the insurer.

b . If a consumer submits a request for an exception as set forth in paragraph “a” , an insurer may, in its sole discretion, but is not required to, do any of the following:

(1) Require the consumer to provide reasonable written and independently verifiable documentation of the event.

(2) Require the consumer to demonstrate that the event had direct and meaningful impact on the consumer’s credit information.

(3) Require such request to be made no more than sixty days from the date of the application for insurance or the policy renewal.

(4) Grant an exception despite the fact that the consumer did not provide the initial request for an exception in writing.

(5) Grant an exception where the consumer asks for consideration of repeated events or the insurer has considered this event previously.

c . An insurer is not out of compliance with any law or rules relating to underwriting, rating, or rate-filing as a result of granting an exception under this subsection . Nothing in this subsection shall be construed to provide a consumer or other insured with a cause of action that does not exist in the absence of this subsection .

d . An insurer shall provide notice to consumers that reasonable exceptions are available pursuant to this subsection and information about how the consumer may inquire further about such exceptions.

e . Within thirty days of the insurer’s receipt of sufficient documentation of an event described in paragraph “a” from a consumer, the insurer shall inform the consumer of the outcome of the consumer’s request for a reasonable exception. Such communication shall be in writing or provided to a consumer using the same medium as the request.

7. Information filed with the commissioner of insurance.

a . An insurer that uses insurance scores to underwrite and rate risks for personal insurance shall file the insurer’s scoring models or other scoring processes with the commissioner of insurance. A third party may file scoring models on behalf of an insurer. Information filed with the commissioner that includes insurance scoring models ~~may~~ <u>shall</u> include ~~information including loss experience that justifies the insurer’s use of credit information~~ <u>such supporting loss experience, models, algorithms, and actuarial and statistical data, and reports sufficient, in discretion of the commissioner of insurance to determine whether the filing should be approved or denied. Failure to provide the information required in this paragraph may result in a denied filing.</u>

b . ~~Information~~ If requested by the submitting party, the insurer's scoring model filed with the commissioner of insurance pursuant to this subsection shall be considered a confidential record, and be recognized and protected as a trade secret pursuant to section 22.7, subsection 3.

8. Indemnification. An insurer shall indemnify, defend, and hold harmless agents or producers of the insurer from and against all liability, fees, and costs, arising out of or relating to the actions, errors, or omissions of an agent or producer who obtains or uses credit information or insurance scores on behalf of an insurer, provided that the agent or producer follows the instructions or procedures established by the insurer and complies with any applicable law or regulation. This subsection shall not be construed to provide a consumer or other insured with a cause of action that does not exist in the absence of this subsection .

9. Consumer reporting agency — sale of credit information.

a . A consumer reporting agency shall not provide or sell data or lists that include any information that was submitted, in whole or in part, in conjunction with an insurance inquiry about a consumer's credit information or a request for a credit report or insurance score. Such information includes, but is not limited to, the expiration dates of an insurance policy or any other information that can be used to identify the expiration date of a consumer's insurance policy or the terms and conditions of the consumer's insurance coverage.

b . This subsection does not apply to the provision of information, including data or lists, by a consumer reporting agency to the agent or producer from whom the information was received, to the insurer on whose behalf the agent or producer acted, or to the insurer's affiliates or holding companies.

c . This subsection shall not be construed to restrict an insurer from obtaining a claims history report or a motor vehicle report of a consumer.

10. *Rules*. The commissioner of insurance may adopt rules for the administration of this section.

~~10~~ 11. Severability. If any subsection, paragraph, sentence, clause, phrase, or any other part of this section is declared invalid due to an interpretation of or a future change in the federal Fair Credit Reporting Act, the remaining subsections, paragraphs, sentences, clauses, phrases, or parts thereof shall be in no manner affected thereby but shall remain in full force and effect.

~~11~~ 12. Applicability date. This section applies to personal insurance contracts or policies delivered, issued for delivery, continued, or renewed in this state on or after October 1, 2004.

V. Conclusions

The use of insurance scoring is a complicated and controversial issue. This is due to many factors, but the concerns over the potential effects on minorities and the unclear causal connection between insurance scores and claims have been raised repeatedly. Much consideration was given to the possibility of recommending a ban on insurance scoring. While this would eliminate the flaws this study has found in the process, an unintended consequence may be an increase in insurance rates for Iowans. Without an accurate idea of the potential cost increase for Iowa consumers that recommendation will not be made at this time. However, to ensure consumer protections to Iowans renewal guidelines, consumer friendly disclosures, more guidance to insurers, and educational outreach on insurance scoring will be used to reduce the potential concerns caused by insurance scoring.

VI. Acknowledgements

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The Departments of Insurance for all 50 states and the District of Columbia

The Iowa Commissioner of Insurance and all the bureaus of the Iowa Insurance Division

The public hearing presenter and participants: The Center for Economic Justice, FICO, Property Casualty Insurers Association, and Transunion

St. Ambrose University

The National Association of Insurance Commissioners

The media and reporters from: The Business Record, The Des Moines Register, Iowa Public Radio, and WHO-TV/DT Des Moines News

VII. Appendices

Part I-Background on Insurance Scoring Appendix:

1A: Choice Point Insurance Scoring Model

Part II-Insurance Scoring Laws Appendices:

2A: State Law Summaries

Part III-Insurance Scoring in Iowa Appendices:

3A: Iowa Information Request

3B: Public Hearing Information

3C: Aggregated Consumer Complaints and Testimony

3D: St. Ambrose Report (includes survey results and authors' analysis)

Part IV-Conclusions Appendices:

4A: Iowa Economic Data

4B: Listing of Additional State Studies on Insurance Scoring

A. <u>Appendix 1A: Choice Point Scoring Model</u>

CHOICEPOINT ATTRACT HOMEOWNERS
SCORE 1

VARIABLE	INTERVAL	INTERVAL POINTS
CONSTANT		1.056300
AGE OF MOST RECENT DEROG PUBLIC RECORD less medical Collection Items	0 - 8	-0.007203
	9 - 27	-0.031766
	28 - 68	-0.084183
	69 or more	-0.153247
	bypass	0.000000
	no pub records	-0.224400
# OF ACCOUNTS ON FILE	1	0.007748
	2	0.016914
	3	0.025371
	4 - 5	0.038230
	6	0.050742
	7	0.059199
	8	0.067656
	9	0.076113
	10	0.084570
	11	0.093027
	12	0.101484
	13	0.109941
	14	0.118398
	15	0.126855
	16 - 17	0.139342
	18	0.152226
	19 - 20	0.164680
	21 - 23	0.185261
	24 - 27	0.214035
	28 or more	0.282583
	bypass	0.000000
	no accts on file	0.007748
WORST ACCOUNT RATING CURRENTLY REPORTE	too new to rate	0.000000
	rate 1 or 2	0.029573
	rate 3, 4 or 5	0.121672
	bad debt	0.170208
	bypass/no acct	0.000000
# OF ACCOUNTS CURRENTLY 30 DAYS LATE	0	0.000000
	1 or more	0.120746
# OF OPEN ACCOUNTS WITH BALANCE GREATER THAN 75% OF HIGH CREDIT/CREDIT LIMIT	0	0.000000
	1	0.022519
	2	0.045038
	3	0.067557
	4	0.090076
	5 or more	0.146835
# OF PERSONAL FINANCE COMPANY ACCOUNTS ALWAYS PAID SATISFACTORY	0	0.000000
	1	-0.030511
	2 - 3	-0.071182
	4 or more	-0.166470

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ChoicePoint Proprietary and Confidential

CHOICEPOINT ATTRACT HOMEOWNERS
SCORE 1 (continued)

VARIABLE	INTERVAL	INTERVAL POINTS
% OF DEPARTMENT STORE ACCOUNTS PAID SATISFACTORY	0.0000 - 0.1875	-0.000151
	0.1876 - 0.3077	-0.016707
	0.3078 - 0.4783	-0.025098
	0.4784 - 0.5625	-0.034922
	0.5626 - 0.6500	-0.041693
	0.6501 - 0.6875	-0.046434
	0.6876 - 0.7391	-0.049659
	0.7392 - 0.8462	-0.054391
	0.8463 - 0.9999	-0.060705
	1.0000 or more	-0.059646
	no dept store	-0.000151
	no accts	0.000000
# OF ACCOUNTS RATED 30 DAYS OR WORSE IN THE LAST 24 MONTHS	0	0.000000
	1	0.028579
	2 - 3	0.067321
	4 or more	0.177835
% OF OPEN BANK REVOLVING ACCOUNTS TO TOTAL OPEN ACCOUNTS	0.0000 - 0.1389	-0.003714
	0.1390 - 0.1786	-0.033125
	0.1787 - 0.2105	-0.041521
	0.2106 - 0.2432	-0.047049
	0.2433 - 0.2813	-0.053330
	0.2814 - 0.3214	-0.061637
	0.3215 - 0.3529	-0.070167
	0.3530 - 0.3947	-0.078285
	0.3948 - 0.4231	-0.084607
	0.4232 - 0.4889	-0.092746
	0.4890 - 0.5938	-0.108017
	0.5939 - 0.6579	-0.128260
	0.6580 - 0.7931	-0.146460
	0.7932 or more	-0.201811
	no bank rev	-0.003714
	no accts	0.000000

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CHOICEPOINT ATTRACT HOMEOWNERS
SCORE 2

VARIABLE	INTERVAL	INTERVAL POINTS
CONSTANT		380.203785
TOTAL NUMBER OF MONTHS OPEN FOR ALL ACCOUNTS	0 - 64	2.046512
	65 - 137	6.524952
	138 - 213	11.386242
	214 - 288	16.306356
	289 - 365	21.237112
	366 - 444	26.285366
	445 - 524	31.456998
	525 - 608	36.784158
	609 - 693	42.297666
	694 - 781	47.893187
	782 - 876	53.841542
	877 - 976	60.161027
	977 - 1083	66.884144
	1084 - 1204	74.225209
	1205 - 1338	82.512413
	1339 - 1499	92.072360
	1500 - 1701	103.741189
	1702 - 1966	118.663359
	1967 - 2408	140.541170
	2409 or more	196.371561
	no accts	0.000000
AGE OF LAST ACTIVITY in months	0	0.000000
	1	-10.062586
	2 or more	-29.213951
% OF OPEN PERSONAL FINANCE COMPANY ACCOUNTS TO TOTAL OPEN ACCOUNTS	0.0000 - 0.1081	-0.339794
	0.1082 - 0.1600	-10.325259
	0.1601 - 0.2963	-17.016760
	0.2964 - or more	-41.457476
	no pers fin accts	-0.339794
	no accts	0.000000
TOTAL BALANCE OWED ON DEPARTMENT STORE ACCOUNTS	0 - 32	0.002766
	33 - 88	0.189149
	89 - 170	0.404820
	171 - 290	0.726062
	291 - 471	1.199965
	472 - 751	1.926201
	752 - 1204	3.058084
	1205 - 2102	5.099938
	2103 or more	11.768779
	no dept store	0.002766
	no accounts	0.000000
# OF SALES FINANCE ACCOUNTS WITH A BALANCE > $0	0	0.000000
	1 or more	-9.682568

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CHOICEPOINT ATTRACT HOMEOWNERS
SCORE 2 CONTINUED

VARIABLE	INTERVAL	INTERVAL POINTS
# OF OPEN BANK INSTALLMENT ACCOUNTS	0	0.000000
	1	-12.466560
	2 or more	-29.681126
# OF AUTO FINANCE ACCOUNTS ALWAYS REPORTED AS SATISFACTORY	0	0.000000
	1	7.180810
	2 or more	17.720612
# OF OPEN CREDIT UNION, S&L, MORTGAGE ACCTS	0	0.000000
	1	1.386071
	2	2.772142
	3 or more	5.025861
TOTAL AVERAGE DEBT BURDEN	0.000 - 0.0092	-0.022200
	0.0093 - 0.0299	-0.322674
	0.0300 - 0.0595	-0.742272
	0.0596 - 0.1011	-1.345628
	0.1012 - 0.1543	-2.154484
	0.1544 - 0.2132	-3.116079
	0.2133 - 0.2720	-4.115917
	0.2721 - 0.3292	-5.096574
	0.3293 - 0.3841	-6.050774
	0.3842 - 0.4369	-6.965746
	0.4370 - 0.4892	-7.852566
	0.4893 - 0.5392	-8.720441
	0.5393 - 0.5906	-9.580939
	0.5907 - 0.6432	-10.461840
	0.6433 - 0.6983	-11.371249
	0.6984 - 0.7568	-12.330910
	0.7569 - 0.8232	-13.383307
	0.8233 - 0.9070	-14.633418
	0.9071 or more	-17.148634
	no accts on file	0.000000
% OF SATISFACTORY ACCTS TO TOTAL ACCTS	0.0000 - 0.1951	2.278798
	0.1952 - 0.3276	9.203608
	0.3277 - 0.4103	13.091549
	0.4104 - 0.4727	15.846733
	0.4728 - 0.4918	17.121371
	0.4919 - 0.5435	18.235398
	0.5436 - 0.5690	19.645937
	0.5691 - 0.5957	20.731816
	0.5958 - 0.6308	21.889532
	0.6309 - 0.6607	22.997973
	0.6608 - 0.7045	24.253845
	0.7046 - 0.7317	25.702557
	0.7318 - 0.7568	26.732752
	0.7569 - 0.7959	27.781497
	0.7960 - 0.8293	28.898425
	0.8294 - 0.8723	30.294531
	0.8724 - 0.9999	32.216657
	1.0000 or more	35.810451
	no accts on file	0.000000

CHOICEPOINT ATTRACT HOMEOWNERS
SCORE 2 CONTINUED

VARIABLE	INTERVAL	INTERVAL POINTS
% OF OPEN RETAIL ACCTS TO TOTAL OPEN ACCTS	0.0000 - 0.0811	-0.173051
	0.0812 - 0.1081	-5.682588
	0.1082 - 0.1389	-7.301420
	0.1390 - 0.1923	-9.674932
	0.1924 - 0.2424	-12.598866
	0.2425 or more	-23.538635
	no retail accts	-0.173051
	no accts	0.000000
% OF OPEN VEHICLE RELATED ACCTS TO TOTAL OPEN ACCTS	0.0000 - 0.0741	-0.086311
	0.0742 or more	-18.187983
	no auto accts	-0.086311
	no accts on file	0.000000
# OF ACCTS OPENED IN LAST 24 MONTHS	0	0.000000
	1	-3.349521
	2	-6.699042
	3	-10.048563
	4	-13.398084
	5	-16.747605
	6 - 7	-21.425159
	8 or more	-33.344743

B. Appendix 2A: State Law Summaries

Insurance Scoring Laws

As of January 1, 2011

State or Jurisdiction	Key Laws / Regulations	Key Provisions
Alabama	Alabama Administrative Code §482-1-127 *et seq.*	Personal Lines: Incorporates provisions similar to NCOIL model act. Noted additional provisions or differences: - Insurer to provide upon request: credit request timeframes, insurance score calculation time frames, whom on the policy the request will be made for, how credit information will be used in calculation of rates, disclosure information for consumers, and adverse action forms. - Not –hits / thin credit files will be given the tier placement the policy would otherwise receive if not for credit unless actuarial support can be provided to allow different treatment. If the file belongs to an insured 55 years old or older, the insured must be treated as having the best credit unless the carrier provides data to support otherwise. - Insurer shall not use the following to rate or underwrite with credit history: number or credit inquires, types of credit cards used by insured, disability, or physical handicap. - Credit history cannot be used in an arbitrary, capricious, or unfairly discriminatory reason.
Alaska	Alaska Statutes § 21.36.460; § 21.39.035	Personal Lines: Disclosure of the use of credit information must be given by the insurer. Adverse action letters include standard Fair Credit Reporting Act requirements as well as requiring insurer to notify consumers of their right to have adverse action reconsidered and to advise consumers on ways to improve the consumer's insurance score. Credit history may be used to deny, cancel, underwrite, and rate a policy only when combined with other substantive underwriting factors. An insurer may not fail to renew or again underwrite or rate a personal insurance policy based

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		in whole or in part on a consumer's credit history or insurance score. This prohibition may only be waived at the request of the insured. The waiver must occur at each renewal before a consumer's credit history may be used again. Absence of credit history or an inability to calculate will be treated neutral as defined by the Commissioner. Prohibitions similar to NCOIL model are implemented with some additional restrictions: - Multiple lender inquiries are restricted for home, auto, boat, and recreational vehicle as long as it is within a 30 day period of time - Age of person when credit was established - The most recent auto and home loans obtained. - Credit history that is based off of medical history Insurance scoring models must be filed with the department. They will be maintained as trade secret and are not available to the public. A general description of the insurance scoring models will be made available to the public, minus any trade secret information. Bulletin 2003-7 clarifies that credit history may only be used once and Bulletin 2004-11 suggests education material for consumers.
Arizona	Arizona Revised Statutes § 44-1692; § 20-1652; § 20-2102; § 20-2110; § 20-2113.01	<u>Personal Lines</u>: An insurer must request credit history information (if used) as soon as practicable when underwriting new policies. If an adverse underwriting decision is made due to credit history, a consumer is entitled to the specific reasons why the adverse decision was made. An insurer may not use the following credit history factors to determine insurance score: - The absence or inability to determine credit history unless actuarially justified or the insurer may decide to treat the consumer as neutral (as defined by the insurer). - A bankruptcy or lien over 7 years old - Collection accounts with a medical code attached - The use of a particular type of credit card unless actuarially justified

State or Jurisdiction	Key Laws / Regulations	Key Provisions
		- A consumer's total available line of credit. An insurance score should not include income, gender, address, zip code, ethnic group, religion, marital status, or nationality of the consumer as a factor.
Arkansas	Arkansas Code § 23-67-401 *et seq.*	Personal Lines: Incorporates the NCOIL model act. Arkansas Insurance director Bulletin 14-2004 provides a report template for tracking the number of policies with increased or decreased premiums due to credit scoring.
California	California Insurance Code § 1861.02; § 1861.05 10 California Code of Regulations § 2648.4	Auto: Rates and premiums for auto insurance are determined by driving record, number of miles driven, the number of years of driving experience, and any other factors the Commissioner adopts by regulation. (Californian's passed Proposition 103 in the late 1980s. This limited the factors that could be used to determine auto rates. The Commissioner has not approved credit history as an additional factor to be used in setting rates. This has resulted in a ban on using credit history to determine auto rates.) Home: California has implemented prior approval procedures for setting rates. (Currently there have been no rates filings using credit history for homeowner's insurance approved.)
Colorado	Colorado Statutes § 12-14.3-103; 10-4-110.7; 10-4-116; §10-4-616 Colorado Code of Reg. § 5-1-16	Personal Lines: Incorporates provisions of the NCOIL mode act. Noted additional provisions or differences: - Insurance scoring methodologies may not include identity theft that may be sufficiently and independently corroborated. The consideration of credit information adversely affected by a dissolution or marriage or by the credit information of a former spouse.

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		Home: If an insurer uses credit history in the underwriting process, consumers must be notified at the time of application.
Connecticut	Connecticut General Statutes §38a-358; §38a-686	Personal Lines: Insurers must file with the Commissioner their financial history measurement program. Such filings are considered trade secret. Insurers that use financial history measurement programs must provide to the commissioner documentation that demonstrates the correlation between the program and the expected loss, the impact on consumers (in urban areas versus nonurban areas), and based on consumers' age. Consumers are permitted to request consideration of the use of extraordinary life circumstances. If granted the insured must be treated as neutral or better than neutral or affected credit information cannot be considered. Insurers must provide disclosures to the consumer regarding the use credit history. The disclosures include notification of the right to have extraordinary life circumstances considered upon notification of an adverse determination. The use of credit history is may be used on new business. Credit history may be used on renewal business if requested by the insured or by the insurer if it will reduce the insured's premium. Insurers shall not use the following characteristics: the number of inquiries, the use of particular types of credit cards, the total available line of credit, disputed credit information while under review, medical collection accounts, and lack of credit history unless they are treated as neutral. All types of specific purchases or financing must be treated the same under a financial history measurement program. Commissioner may require the submission of a report about an insurer's financial history measurement program that may include an analysis of complaints, supportive data, and

State or Jurisdiction	Key Laws / Regulations	Key Provisions
		demonstrate that the use of financial history is not unfairly discriminatory. Insurers shall not decline or nonrenewal a policy based solely on credit history.
Delaware	Delaware Code, Title 18 § 8301 *et seq*. Delaware Code of Regulation § 18-900-906-.01 *et seq*.	<u>Personal Lines</u>: Insurers are prohibited from underwriting new risks based solely on credit reports or credit information. Insurers may not take adverse action against a currently in force insured based on credit information or changes in a credit report. Consumers (or agents) may request that the company rerate a consumer based on new credit information annually. The rerating is permitted for decreasing premium only and may not be used to adversely affect consumers. A transferred book of business due to a change in agent or insurer shall be treated as renewal policies in regards to the use of credit. The transferred book of business will not be permitted to rate policies as new business. Provisions similar to those used by NCOIL model are used for the dispute resolution and adverse action notifications. An insurer may not use a credit report or score older than two years to rate a new policy. Insurers are prohibited from considering race, color, creed, sex, religion, national origin, place of residency, marital status, nature of employment, physical disability, or any category banned by federal or state law. Models must be filed with the Commissioner for underwriting and rating. Models must contain: - Supporting algorithms, - Actuarial or statistical data, - Reports sufficient in the discretion of the Commissioner to make a determination that

State or Jurisdiction	Key Laws / Regulations	Key Provisions
		the use of credit will not unfairly discriminate and the use of tier based criteria is supported. Third party vendors are permitted to work with insurers only if they are willing to fully share requested information and cooperate with the Commissioner. Only the credit information of those named on the insurance policy may be reviewed. Insurers are prohibited from using obsolete information. This includes items on a report over seven years old (or 10 years old fro bankruptcies). Insurers are prohibited from considering credit information that is disputed if it will cause adverse action. Insurers are prohibited from considering the total available line of credit, but may consider the debit to available credit ratio. Insufficient credit and no credit histories can be used if actuarially justified and consistent with the rate filed with the Commissioner. An extraordinary life circumstances provision is incorporated.
District of Columbia	No Law or Regulation on Issue	None
Florida	Florida Statutes Annotated § 626.9741 § 626.9742 Florida Administrative Rules § 690-125.004	<u>Personal Lines</u>: Incorporates NCOIL model act. Noted additional provisions or differences: - Rates may not be excessive, inadequate, unfairly discriminatory, destructive of completion, or detrimental to the solvency of the insurer. - Insurers are prohibited from considering place of residence or any circumstance decided by the Financial Services commission by rule, lacks statistical correlation and actuarial justification as a predictor of insurance risk. - Incorporates extraordinary life circumstances exception

State or Jurisdiction	Key Laws / Regulations	Key Provisions
		- Insurer is required to review credit history every 2 years for consumers that have been adversely affected by the use of credit in the initial or renewal rating of a policy. The review may also be conducted at the request of the insured. The insurer shall adjust the premium of the insured to reflect any improvement in the credit history. <u>Home and Auto Specifically</u>: Insurers must establish procedures detailing when and how credit may be used in underwriting decisions. Records must be retains as evidence of compliance for the Department's examination.
Georgia	Georgia Code Annotated § 33-24-90 *et seq*. Georgia Regulations § 120-2-15-.01; §120-2-15-.02; § 120-2-65-.01	<u>Personal Lines</u>: Incorporates the NCOIL model act. Noted additional provisions or differences: - Homeowners: Insurers are required every quarter to provide a list of all canceled and non-renewed polices and the reasoning for the action to the Commissioner. One of the possible reasons provided is credit reports. - Auto: Underwriting may not use criteria or guidelines that create fictitious groupings that result in unfair discrimination. Credit reports and history are included in the definition of groupings.
Hawaii	Hawaii Revised Statutes § 431:10C-207	<u>Auto</u>: Use of credit information is prohibited. (HI banned credit information in auto in the 1970s. When the statute was revised, the ban was maintained as status quo. The prohibition is on auto only. HI has no laws or regulations restricting the use of credit information for homeowner's insurance.)
Idaho	Idaho Code § 41-1843 Idaho Admin. Code § 18.01.19 *et seq*.	<u>Personal Lines</u>: Insurers are prohibited from charging higher premiums, canceling, decline to issue or nonrenew a policy based primarily on credit rating or credit history. The aggregate weight given to the non-credit factors must, at minimum, be as great as the total for the credit factors used.

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		An insurer must be able to show in rating new business that credit factors did not contribute more than one-half of the total premiums. Based primarily is defined as the weight given by the insurer to credit rating or history must not exceed the weight given to all the other factors considered in rating and underwriting. Information submitted to the department will have trade secret status and will not be available to the public.
Illinois	215 Illinois Compiled Statutes Annotated § 157/1 *et seq*.	<u>Personal Lines</u>: Incorporates the NCOIL model act. Noted additional provisions or differences: - An applicant is incorporated into the definition of a consumer - An insurer shall not be considered to have denied, cancelled, or nonrenewed a policy if coverage is available through an affiliate. If an insurer denies, cancels, or does not renew a policy of personal insurance based on credit information, it must provide notice and the consumer must be given an opportunity to explain the credit information. - It is acceptable to base rates solely on credit information if coverage is available in a different tier of the same insurer. - Insurers are not required to re-order credit and re-rate policyholders based on current credit information every 36 months. - If insurers do not treat insured's neutral because they cannot obtain an insurance score due to insufficient credit or no credit then the filing must include a certified actuarial justification statement signed by an officer of the insurer for their treatment of the insured. - IL does not provide for an indemnification section.
Indiana	Indiana Code § 21-2-21 *et seq.*	<u>Personal Lines</u>: Incorporates the NCOIL model act. Noted differences from model:

State or Jurisdiction	Key Laws / Regulations	Key Provisions
		- Insurers are not permitted to consider credit information related to medical codes. Insurers are also no longer required to review credit reports every three years. - The NCOIL provision that allows insures to exclude the use of credit in underwriting for individuals that have an absence of credit or an inability to calculate scores has been removed. Bulletin 176: Provides guidance as to filing of insurance score models. Encourages adoption of procedures for rating exceptions in consideration of extraordinary life circumstances.
Iowa	Iowa Code §515.103	Personal Lines: Incorporates the NCOIL model act. Noted differences from the model: - The NCOIL provision that allows an insurer to determine the placement of consumers with an inability to calculate a score or an absence of credit to be determined by information related to risk as approved by the Commissioner is removed.
Kansas	Kansas Statutes Annotated § 40-5101 *et seq*. Kansas Regulation § 40-1-50	Personal Lines: Incorporates the NCOIL model act. Noted additional provisions or differences: - The NCOIL provision that allows an insurer to determine the placement of consumers with an inability to calculate a score or an absence of credit to be determined by information related to risk as approved by the Commissioner is removed. - Insurers must re-underwrite and rerate a policy at renewal based on a current credit report or insurance score if request by the consumer. The information must be used if it will reduce the consumer's rate. The information may not be used to increase rates. - Insurers must provide a procedure for a consumer to review a credit based adverse action. - The Commissioner of insurance is authorized to adopt rules and regulation s as necessary. - An insurer must provide the insured with each reason for the change in their premium or coverage. - Insurers are required to maintain a record of the contents of the credit information used for five years after an adverse action is taken.

State or Jurisdiction	Key Laws / Regulations	Key Provisions
Kentucky	Kentucky Revised Statutes Annotated § 304.20-040	Auto: An insurer is prohibited from declining, refusing to renew, or canceling a policy solely based on credit history or a lack of credit history.
Louisiana	Louisiana revised Statutes Annotated § 22:1501 *et seq.*	Personal Lines: Incorporates the NCOIL model act. Noted additional provisions or differences: - An insurance scoring methodology is prohibited from including: o promotional inquires, periodic inquiries by existing credit providers, or credit system administration inquiries. o The extension of available credit in excess of what the insurer deems reasonable, when the consumer has an otherwise acceptable credit history and does not present an increased underwriting or rating risk. o Create unreasonable disparities between underwriting tier placement between different lines of insurance for the same applicant solely based on credit information unless actuarially or statistically justified or based on sound underwriting criteria without considering other underwriting factors independent of credit. - Insurers shall provide a process for the consumer to appeal the underwriting or rating of risk based on credit scoring may not be appropriate.
Maine	Main Revised Statutes Title 10 § 1313-A; Title 10 § 1315 Title 24-A § 2917; Title 24-A § 2169-B	Personal Lines: Incorporates the NCOIL model act. Noted additional provisions or differences: - Insurers shall not consider an absence of credit information, inquiries, or an inability to calculate an insurance score unless the insurer demonstrates to the Superintendent the information is a relevant factor to the risk underwritten or rated and the factors are applied in an approved fashion. - A filing that includes insurance scoring must include loss experience justifying the use of credit information if required by the superintendent. Personal Automobile:

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		Notice must be given for a automobile non-renewal. The notice must include reasons for non-renewal including a credit report.
Maryland	Maryland Code § 27-501; §11-317 Maryland Regulation § 31.15.11 *et seq*.	<u>Homeowners</u>: The use of credit history is prohibited in rating and underwriting. <u>Auto</u>: Insurer must provide at the time of issuance a description of factors that may contribute to premium increases (including credit) at the time of issuance. Insurer may not refuse to underwrite, cancel, renew, increase renewal premium (in whole or in part), or require a specific payment plan based on credit history. Credit history may be used for new polices subject to the following prohibitions: - May not use credit history factors older than 5 years - Upon request of applicant identify the portion of the premium attributed to credit history - May not consider number of credit inquires about credit history, the absence of credit history, or an inability to calculate a score - May not consider credit inquires about the applicant's credit history Credit history may be reviewed upon request of the insured that has been adversely affected by credit history in the initial rating of policy. Credit history shall be reviewed every 2 years without the insured request. Premium will be adjusted only if there is an improvement in credit history. If actuarially justified, up to a 40% discount and surcharge may be applied. A group of affiliated insurers are considered a single insurer. Credit criteria or credit score shall not be excessive, inadequate, or unfairly discriminatory. Credit criteria or credit score shall be used in a manner that places the applicant in the most favorable tier and most favorable affiliate in which the applicant qualifies.

State or Jurisdiction	Key Laws / Regulations	Key Provisions
		Rate filings and rate-related underwriting rules must be filed. Information provided must include underlying information, statistical validation, and credit criteria/ranges of credit scores. Additional information is required upon the request of the Commissioner.
Massachusetts	Massachusetts General Laws Annotated Chapter 93 § 51; §62 Code of Massachusetts Regulations §211-79.5(13)	<u>Personal Lines</u>: Massachusetts law establishes authority over credit reporting agencies. Allows insurers access to credit reports for underwriting purposes. Similar to the Fair Credit Reporting Act, insurers are to provide notification to consumers in regards to adverse actions. <u>Private Passenger Auto</u>: No credit information contained on a consumer report obtained from a consumer reporting agency pursuant to G.L. c. 93, § 50 et seq. shall be used in private passenger motor vehicle insurance: 1. rating, including its use in any Classification Plans, rules or Rates, rating plans or modification of any of the foregoing; or 2. 2. underwriting, including its use to determine whether to issue, renew or execute as surety a private passenger motor vehicle liability policy or bond, or any other insurance based on the ownership or operation of a motor vehicle, or to determine the placement in a particular affiliate within an Insurance Company Group. Nothing in 211 CMR 79.05(13) shall be construed to restrict any Insurer from obtaining or using information contained in an insurance claims history report, a motor vehicle or driver history report, or any other report from the Massachusetts Registry of Motor Vehicles or its out-of-state equivalent. (Until 2008 Massachusetts was the only remaining state in which the Commissioner of Insurance set auto rates.)
Michigan	Michigan Compiled Laws § 500.2109(1)(c); MCL 500.2403(1)(d); 500.2603(1)(d) Office of Financial and	<u>All Personal Lines</u>: Insurers using insurance scoring must file their formulas with the Office of Financial and Insurance Services (OFIS). The specific credit classification factors used must be filed with OFIS and refilled when changed.

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	Insurance Services (OFIS) Bulletin 2003-01-INS and 2003-02-INS	Automobile and Homeowners: Insurers must file actuarial justification and certification for the discount levels and discount tiers. Actuarial certification must be provided for discounts provided to “no hit” and “thin file” policyholders and applicants. Insurers must recalculate an insurance score annually at the request of the policyholder. Insurers must inform policyholders and applicants that insurance scoring is used and share which discount tier they have been placed in. Insurers are encouraged to share the primary factors that adversely contribute to a score in clear and specific language to the consumer. Insurers are reminded of their Fair Credit Reporting Act responsibilities.
Minnesota	Minnesota Statutes Annotated § 72A.20, subd. 36 §72A.501, subd. 2	Personal Lines: Insurers are prohibited from rejecting, canceling, or failing to renew an auto or homeowner’s policy in whole or in part based on credit information without considering another factor. Insurers are prohibited from considering non-consumer initiated inquiries in calculating an insurance score. Insurers must exclude credit as a factor in a decision to reject, cancel, or non-renew a policy that is based on an absence of credit history. Consumers can request a reevaluation of their insurance score twice a policy year. Insurers must offer exceptions for extraordinary life events Insurance scoring methodology may not include gender, race, nationality, or religion. Scoring models and methodology must be filed with the Commissioner. Insurers must file

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		prior to implementation the use of the scoring system. Filed information will be maintained as trade secret.
Mississippi	Mississippi Regulations § 2003-1.1 *et seq*.	Personal Lines: Incorporates provisions of the NCOIL model act. Noted additional provisions or differences: - An insurer must maintain for Department inspection written procedures regarding credit history and insurance scores. This should include when credit histories are ordered, about whom such information will be ordered and calculated, and how such information will be used. - Insurers must file insurance scoring models. Filings must include the factors or characteristics pulled from credit histories, the algorithm, computer program, model, or other process used to determine and insurance score. - If a consumer would be eligible for a particular rate or tier based on all other criteria save for an insurance score is unavailable (absent credit/inability to calculate), the consumer will be given that rate or tier unless actuarial documentation is provided otherwise and the Department agrees. - Insurers are prohibited from using insurance scores in an arbitrary, capricious, or unfairly discriminatory reason. - Insurers are prohibited from denying, cancelling, non-renewing, calculate insurance scores, determining tier placement, or setting rates or premiums based on the type of credit card used by consumers or credit information that is disputed on a credit report (if know by the insurer). - Insurers are prohibited from determining initial or renewal rates based on credit history or insurance score solely on credit history if an insurance score is based solely on credit history.
Missouri	Missouri Revised Statutes § 375.918	Personal Lines: Incorporates some provisions of the NCOIL model act.

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	20 Code of State Regulations 500-9.100	Noted additional provisions or differences: - Insurers may not take adverse action on a disputed credit report information until dispute is resolved. - Consumer may request reasons behind the adverse action taken against them based on credit. - Insurer may use credit history on new and renewal policy contracts, but may not take adverse action against a consumer on renewals based on credit until the third anniversary of the initial contract. <u>Home</u>: Underwriting guidelines must be filed with Insurance Department.
Montana	Montana Code Annotated § 31-3-111; § 33-18-601 *et seq*.	<u>Personal Lines</u>: Incorporates the NCOIL model act. Noted additional provisions or differences: - The following are prohibited from being considered as a negative factor by the insurer: o The number of credit inquiries o The use or type of a particular type of credit card, charge card, or debit card, or the number of credit cards obtained by a consumer o A loan if it is evident from the credit report that it is for the purchase of a automobile or personal residence (but payment history may be considered), o The total available credit or total debt (payment history may be considered), o And the total amount of outstanding debt if it exceeds the total line of credit. An extraordinary life event exception is incorporated into the law.
Nebraska	Nebraska Revised Statutes Annotated § 44-7516.01; § 44-7701 *et seq*.	<u>Personal Lines</u>: Incorporates the NCOIL model act. <u>Auto</u>:

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		Auto policies using credit that are issued, delivered, or renewed must be accompanied by a disclosure notifying the insured that a credit based rating was used.
Nevada	Nevada revised Statutes § 686A.600 *et seq*. Navada Administrative Code § 686A.700; § 686A.710	<u>Personal Lines</u>: Incorporates the NCOIL model act. Noted additional provisions or differences: - And insurer shall not use an insurance score that would lead to unfair or invidious discrimination. - If a consumer has more than one policy with the same insurer, with different effective dates, the credit information for the policy with the earliest effective date may be used for renewal purposes. The credit information is prohibited from being older than thirty-six months.
New Hampshire	New Hampshire Revised Statutes § 359-B:4; § 412:15;	<u>Auto and Home</u>: Insurers must establish written procedures for using insurance scores. Those procedures must incorporation prohibitions on using race, color, creed, sex, religion, national origin, place of residency, blindness, or any other physical handicap or disability. The procedures are prohibited from being arbitrary, capricious, or unfairly discriminatory. Insurance scores may not be used in calculating insurance scores in whole or in part. Rate and underwriting models must be filed with the Insurance Department. Insurance scores shall be updated at least every thirty-six months. Use of credit history in underwriting and rating shall be based on objective, documented, and measurable standards.
New Jersey	New Jersey Statute Annotated § 56:11 *et seq*.	<u>Personal Lines</u>: State has established a Fair Credit Reporting Act (similar to the Fair Credit Reporting Act). Insurers are required to meet the consumer protections under the Fair Credit Reporting Act.
New Mexico	New Mexico Statutes §59A-17A	<u>Personal Lines</u>: Incorporates main provisions of NCOIL model act.

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	New Mexico Regulations 13.8.6.1 *et seq*.	Noted additional provisions or differences: - Consumers with an absence or credit history or an inability to calculate credit history must be treated as average, better than average, or credit history can be excluded. - Extraordinary life events exceptions have been incorporated into the credit laws. Sample language is provided for insurers who have taken adverse actions against a consumer. The suggested language provides details on the extraordinary life events exception and how a consumer may qualify. The event needs to have taken place within three years of the filing of insurance. A life exceptions policy may be disapproved if the policy is found inadequate.
New York	New York General Business Law § 380-c New York Regulations Title 11 § 221.0 *et seq*. New York Insurance Law § 2801 *et seq*.	<u>Personal Lines</u>: Incorporates substantial portions of NCOIL model act language. Differences from the NCOIL model and Additional Provisions: - The NCOIL language on renewals is not followed. Instead the use of credit information to cancel or take adverse action is prohibited. Insurers are permitted to place a consumer in a higher tier or reclassify a consumer based on non-credit information. - Adverse action may not be taken against at consumer solely based on not having a credit card - An insurer must treat consumers with an absence of credit or consumers with an inability to calculate credit as neutral, exclude the use of credit information from underwriting criteria, or make a filling for that individual consumer to be approved by the Superintendant. - An insurer is permitted to use credit in conjunction with other underwriting factors that are independent of credit to deny the issuance of a new policy. - Placement with an affiliated insurer or in a tier is considered adverse action if the placement is less favorable then if the consumer's credit had not been considered.

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		- Credit may be used by insurers at the time of renewal if such use will allow for a reduction in premiums.
		
		- Disclosure language must be:
		  o Clear and specific
		  o Inform the consumer that the company may use credit
		  o Give and explanation of insurance scoring
		  o List typical items in a credit history that can affect an insurance score
		  o Provide the name of the credit reporting agency used.
		
		- Disclosure of the use of credit must be provided during the initial application and again at renewal (if credit is used)
		
		- Scoring models are required to be filed with the Superintendant. Filings should contain:
		  o A list of all the factors used in the model and relative importance of such factor
		  o The actual algorithms, computer programs, models, or other processes used to create the insurance scores.
		  o A least three distinct and detailed examples of insurance score calculations using the filed models
		  o Loss experience justifying the use of credit information may also be used
		  o the name version and edited date of the model
		  o a detailed description of the credit information and insurance data that were used in the development of the scoring model, including but not limited to the source and time periods associated with such information and data
		
		- Authorization must be given by the consumer before a credit report can be procured. If the consumer declines to provide authorization, the consumer's application for insurance may be declined.
		
		<u>Auto</u>:
		Insurers are permitted to use a multi-tier programs that are approved by the Superintendent

North Carolina	North Carolina General	<u>Personal Lines:</u>

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	Statutes § 58-36-90	Insurers are prohibited from terminating and existing policy or rating a policy solely based on credit scoring. Insurers are permitted to use credit scoring as the sole factor for discounting. Must provide notice of adverse action. Primary credit score factors that contributed to the adverse action must be must be provided. Insurers must file scoring models. Insurers may request trade secret status for parts of filing designated as such. Incorporates NCOIL dispute resolution rules.
North Dakota	North Dakota Century Code Annotated § 26.1-25.1-01 *et seq*.	<u>Personal Lines</u>: Incorporates the NCOIL model act provisions. Noted additional provisions or differences: - An insurer may use a credit report that is 120 days old to take adverse action.
Ohio	Ohio Administrative Code § 3901-1-55	<u>Personal Lines</u>: Credit cannot be the sole underwriting or rating factor for underwriting, premium determination, or adverse action. Credit scoring methodology may not include the following: - Credit inquires not initiated by the consumer - Credit inquiries relating to insurance coverage - Disputed credit report information if identified as such on the consumer reporting agency - Collections information with medical codes - Multiple lender inquires for home and auto mobile loans
Oklahoma	Oklahoma Statutes Annotated Title 36 § 950 *et seq*.	<u>Personal Lines</u>: Incorporates NCOIL model act.
Oregon	Oregon Revised	<u>Personal Lines</u>:

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	Statutes § 746.650(5); § 746.600(1)(a) (E)(iii); § 746.661 *et seq.*; §746.662 Oregon Administrative Rules § 836-080-0425 *et seq.*; § 836-080-0430; § 836-080-0435; §836-080-0436; §836-080-0438	Incorporates provisions of Fair Credit Reporting Act disclosure requirements are incorporated. Insurers may not cancel or nonrenew a policy that has been in effect for more than 60 days based on credit history or insurance score in whole or in part. If an insurer declines coverage on the initial underwriting of a policy, credit history may be a basis, but only with other substantive underwriting factors. Insurers are prohibited from using the following types of credit history to decline, calculate an insurance score, determine premiums, or rates: - Credit inquires not initiated by the consumer - Inquiries requested by the consumer for the consumers own information - Multiple lender inquires indentified as being for home mortgage or automobile lending made and made within 30 days of each other - Inquires related and identified as related to insurance coverage - A consumer's total available line of credit unless it is in relation to outstanding debit The inability to determine an applicant's credit history (no score) is a separate rating category from an absence of a credit history ("no hit"). For both groups the insurer can assign these applicants a neutral credit history or provide support for the credit history factor for each of these groups. A consumer may not be rerated based on the credit history component when the marital status of a consumer has changed due to death or divorce. An insurer is prohibited from canceling or nonrewnewing a policy in whole or part based on a consumer's credit history or insurance score. Only rating factors other than credit history may be used to rerate a policy at renewal. Upon the consumer's request, a policy's credit history or insurance score may be reevaluated annually. The reevaluation must follow the standards that were used for the initial underwriting. The consumer must have been assigned to a less favorable category in whole or in part to credit history when initially applying for the same insurance. A consumer may not be

State or Jurisdiction	Key Laws / Regulations	Key Provisions
		assigned to a less favorable rate category after reevaluating credit history. Insurer must inform the consumer of any potential negative effects of rerating a policy. Insurance scoring models and all other factors used in calculation shall be filed with the Director of Insurance. This information will be considered confidential and not subject to disclosure.
Pennsylvania	No Law or Regulation	Personal Lines: (Pennsylvania is a prior approval state and has a history of performing rigorous actuarial reviews of filings. There have been no approved rate filings for using insurance scores on renewal policies as yet.)
Rhode Island	Rhode Island General Laws § 27-9-56; § 6-13.1-21; Insurance Regulation 16, 25, and 116	Personal Lines: An insurer that uses insurance scoring must demonstrate the predictive nature of the score to the Insurance Division. A consumer may request an insurance score update every two years. The update score shall act to decrease premiums, where there is an improvement and a decrease is appropriate. An insurer is prohibited from increasing premiums based on a decrease in insurance score unless the decrease is: - confirmed six months later - Due to bankruptcy, foreclosure, tax lien, garnishment, or judgment. Any decrease or increase in premium must be done at renewal. An insurer is prohibited from declining, canceling, failing to renew, or increase the rate of an existing consumer solely based on credit unless it is: - confirmed six months later - Due to bankruptcy, foreclosure, tax lien, garnishment, or judgment Insurers are prohibited from using the following as a negative factor in the insurance scoring methodology: - Credit inquires not initiated by the consumer

State or Jurisdiction	Key Laws / Regulations	Key Provisions
		- Inquires from the consumer to gain his or her own credit information - Insurance inquiries - Collections accounts with medical codes - Multiple lender inquiries if coded for the business of home mortgage or automobile lending, if made within 30 days of each other Individuals must be informed that an insurer will request a credit report before the request is made. Adverse actions taken on a family or household policy must notify the actual individual who was the source of the adverse action. Extraordinary life events protections have been added
South Carolina	South Carolina Code Annotated § 38-73-425; § 38-73-740	<u>Auto:</u> Insurers must maintain credit reports used in investigating consumers on file for three years for inspection by that consumer. Absence of credit information may be used if insurer proves to the Director that it is related to the consumer's risk. Bulletin 2004-12 clarifies that scoring based on an absence of credit will require prior approval.
South Dakota	No Law or Regulation	<u>Personal Lines</u>: Bulletin 2002-3 provides guidance on the use of credit history in insurance. Insurers may not deny, cancel, or nonrenew a policy of personal insurance based on credit information as the sole determining factor. Insurers may not make adverse underwriting or rating decisions based on nationality, race or religion. The bulletin also treats no credit or the inability to calculate credit in a similar manner as the NCOIL model act.
Tennessee	Tennessee Code Annotated § 56-5-401 *et seq*.	<u>Personal Lines</u>: Incorporates the NCOIL model act. Noted additional provisions or differences:

State or Jurisdiction	Key Laws / Regulations	Key Provisions
	Insurance Bulletin dated 12-13-2004	- Any additional factors considered must be independent of credit information.
Texas	Texas Insurance Code § 559.001 *et seq*. 28 Texas Admin. Code § 5.9940, § 5.9941	Personal Lines: Incorporates provisions of NCOIL model act. Noted additional provisions or differences: - Insurers may not use factors that constitute unfair discrimination. - Statistical, actuarial, or reasonable information must be provided to justify the treatment of absence of credit / inability to determine credit information as other than neutral. - Insurer must provide the names of each person on the policy in which credit information is reviewed. - Filed credit scoring models are considered public information. - An insurer may change rates based solely from credit scoring if the changes are based on sound actuarial principles. - There is no limitation on the usage of credit models which is specific to the case of renewal rates. - There's no requirement that the credit report must be issued or the insurance score must be calculated within 90 days of writing/renewing. - There's no requirement concerning rescoring (other than when dispute resolution leads to corrected information). - There's no requirement concerning timing or medium of an insurer's response to a request for an exception due to extraordinary events. - There is a disclosure form which includes a summary of consumer protections related to credit scoring. An insurer may use its own form in place of the Texas Department of Insurance promulgated form if that form has already been approved in another state, but the form must provide similar content and must be approved in Texas before it may be used. An extraordinary events provision is incorporated into the statute that predates the NCOIL amendment on the same issue. Fewer events are included.

State or Jurisdiction	Key Laws / Regulations	Key Provisions
Utah	Utah Code § 31A-22-1307; § 31A-22-320 Utah Admin. Code of Reg. § 590-219-1 *et seq*.	<u>Home</u>: An insurer must identify the circumstance and manner a consumer report will be used. Prior notice must be given before possible or intended use. Records of compliance in these areas must be maintained and available for Commissioner's request. <u>Auto</u>: Credit information may be used in initial underwriting of a policy if additional risk factors are considered. Initial underwriting does not include adding new drivers to a policy. Policy holders are cannot be penalized for adding newly licensed drivers to a policy based on credit information if the policy has been in effect for 60 days or more. Insurers are permitted to place a policy with an affiliate based on credit information. Credit information may also be used in the initial underwriting of a policy if used as a discount. The discount cannot be removed or reduced based on credit information only. Insures may not use credit to renew, non-renew, terminate, determine eligibility, underwrite or rate (except for provided exceptions on initial policies).
Vermont	No Law or Regulation on Issue	None
Virginia	Virginia Code Annotated § 38.2-2126; § 38.2-2234; 38.2-2114; § 38.2-2212	<u>Personal lines – Auto and Home/Rental</u>: Incorporates language from NCOIL model act. Noted additional provisions or differences: - An insurer must notify a consumer of the primary adverse factors when adverse action is taken or must notify a consumer that such information may be requested. - A consumer may request to have their credit information updated. If the updated is requested within 45 days of renewal, the insurer may apply premium adjustments at the upcoming renewal or the second renewal after the request is made.

State or Jurisdiction	Key Laws / Regulations	Key Provisions

		- Prohibited factors for consideration include:
		    o Disputed information if it will result in adverse action,
		    o Non-consumer initiated inquiries,
		    o The total available line of credit,
		    o No provision is incorporated for consumer initiated inquiries made for the purpose of personal credit information.
		- A catastrophic (life) event exception is incorporated
		- Insurers must offer an appeal process for consumers who request that their credit information should be re-evaluated. If the re-evaluation results in a lower premium it must be given retroactively.
		
		*Please note that while the language pertaining to auto and homeowners/rental is similar, the applicable statutory language for the separate lines of insurance are found in and separate statutes.
		
		<u>All Lines (commercial and personal)</u>:
		Administrative letter 2002-6 informs insurers that models must be filed with the Commission.

Washington	Revised Code of Washington § 19.182.020 § 48.18.545; § 48.19.035 Washington Administrative Code § 284-24A-001 *et seq*.	<u>Personal Lines</u>: The definition of personal lines includes auto, home, dwelling, earthquake, personal liability and theft coverage, inland marine coverage, and mechanical breakdown coverage for personal auto or home appliances. Insurers are prohibited from canceling or nonrenewing a policy in whole or in part based on credit history or insurance score. An insurer may use credit history to deny person al insurance only in combination with other substantive underwriting factors. Insurers are prohibited from considering the following to deny coverage based on credit history: - The absence of credit history or an inability to determine a consumer’s credit history - The number of credit inquires - Medical collection accounts

State or Jurisdiction	Key Laws / Regulations	Key Provisions
		- The use of a particular type of credit card, charge card, or debit card - The total available line of credit, except in relation to total outstanding debt - The initial purchase or finance of a vehicle or house when a new loan is added to a consumer's existing credit history Adverse action information must include information that helps the consumer determine why the consumer was charged a higher premium including: - A description of the adverse attribute - How the adverse attribute affected the insurance score - Any actions available to the consumer that may improve this adverse attribute - Any insurance industry research or studies used to justify the effect of insurance scores on premiums (to be filed with the Insurance Commissioner for public disclosure) The term "unfavorable" may not be used to describe an attribute in an adverse action as it does not provide clarity to consumers. Insurance scoring must be filed with insurance Commissioner and are considered confidential. An insurer or vendor may choose to make their insurance scoring model public. Model vendors may file on behalf of insurers. Subsequent filings by related insurers must include a transmittal form, references to the vendor that filed the model, references to the vendor's filing number, statements as to the models use (underwriting, rating, or both), the effective date for insurer's use of the model. Insurers should submit a multivariate analysis when submitting insurance score model filings for actuarial review to ensure rates are not excessive, inadequate, or unfairly discriminatory. Actuarial data must be submitted to justify an insurer's treatment of consumers with an absence of credit history or an inability to calculate credit history.
West Virginia	W. Virginia code Annotated § 33-6B-3; § 33-17A-6	<u>Personal Lines</u>: An insurer is prohibited from declining or terminating a policy based solely on an adverse credit report or adverse credit score.

State or Jurisdiction	Key Laws / Regulations	Key Provisions
		Information letter 142B notifies insurers of the Commissioner's internal policy regarding the use of insurance scoring. Internal policy holds: - An insurer (or third party vendor) will maintain documentation showing that the data used is not unfairly discriminatory based on age, race, socioeconomic class, occupation, nationality, religion, sex, or handicap directly or indirectly. The documentation must also demonstrate that it is a predictor of loss. Random testing must be done to audit accuracy, - Insurance scoring shall not be the sole basis for declining coverage, - Use of NCOIL's adverse action notification and absence of credit, inability to calculate, and disputed credit information language, - Changes in models, methodology, and the source of credit reports must be consistent and may not be changed more than once a year. - If an insurer uses credit information for rating and tier placement, notice of this information must be provided to consumers 60 days before each renewal. - No adverse action may be given unless the credit information or insurance score is within 90 days old. - Insurance scores must be checked every 36 months. - An insured may annually request a recalculation of underwriting and rating.
Wisconsin	No specific laws or regulations	Personal Lines: Guidance is provided on the use of credit reports in a June 16, 1997 bulletin. Insurers should not use credit history as the sole factor to refuse, cancel, or nonrenew an existing policy. Insurer should have written criteria on the use of credit information that is quantifiable. Insurer should disclose the use of credit reports to the consumer. Insurer should establish guidelines for the timeliness of the credit information used. Use of credit information may not be unfairly discriminatory.
Wyoming	Wyoming Statutes	Personal Lines:

State or Jurisdiction	Key Laws / Regulations	Key Provisions
	Annotated § 26-2-134	Commissioner is authorized to adopt rules necessary to govern the use of credit scoring. Commissioner's rules shall provide that: - Credit history shall not be the sole basis to cancel, deny or nonrenew an insurance policy. Credit history must be used with other underwriting factors that are independent of credit history. - A consumer is protected from unfair discrimination in the use of credit scoring to underwrite polices. - An insurer provide notice when credit scoring is used to underwrite a policy or if it results in adverse action.

C. Appendix 3A: Iowa Information Request

<ADDRESS>

<ADDRESS>

Attention Compliance Manager

RE: Information Request

Dear Compliance Manager,

Early this year the Iowa Insurance Division announced a study to investigate the use of insurance scores in Iowa. The purpose of the study is to conduct an in-depth investigation into the current practices, controversies, and opinions about the use of insurance scoring in Iowa to determine what policy is best for our consumers. The results of the study will be presented to the Iowa Insurance Commissioner in November 2009.

In order to conduct a fair investigation on this matter, it is necessary to review as many sources of information as possible. The information reviewed includes other studies, testimony from interested parties, and reviewing rate filings. To supplement the information the Insurance Division has in your rate filings, please provide answers to the following questions.

1) What is the total number of Iowa private passenger automobile and separately, homeowners policies your company wrote in 2008? If auto and homeowners policies are sold as a package policy, please indicate separately the number of policies that include personal auto coverage and those that include homeowners coverage. Please do not include within the policy counts tenants or condo owners policies or policies for other lines of business such as motorcycle and dwelling fire.

2) If your company uses insurance scores, as defined by Iowa Code §515.103(1)h as part of the rating process for personal auto or homeowners coverage, please provide the number of policies at each distinct level of insurance scores for which a rate may differ based on the score. Provide a separate count of those policies for which there was an absence of credit information or an inability to calculate an insurance score and indicate into which tier these policies are placed. The total of the counts by insurance score level in this question should be equal to the total count by policy type in question (1). If you do not use insurance scores in rating either personal auto or homeowners coverage in Iowa, please state that.

3) For each of the tiers listed in question (2) please provide the *arithmetic average* insurance score for policies written in 2008.
    a. Also, please provide the maximum and minimum insurance score for the policies in each tier for that same year.

4) For each of the tiers listed in question (2) please provide the rate differential used in your company's rating plan.

    a. Also, please provide the maximum and minimum premiums for policies written within that tier in 2008.

b. Finally, for each tier, provide the premium that would be charged a hypothetical policyholder as described on the following page. If there are factors not specified for the hypothetical policyholder, please list the factor and provide the range of possible premiums including consideration of the factor.

5) Iowa Code §515.103(2)e(1)requires that insurers treat consumers with an absence of credit information or for whom there is an inability to calculate an insurance score as if the consumer has neutral credit information, as defined by the insurer. How does your company define "neutral credit information?"

   a. Please specify any criteria used and the method of determining "neutral credit information."

   b. How often and under what circumstances are the definition and the calculation updated?

All answers should be submitted via email to angel.robinson@iid.iowa.gov no later than October 9th, 2009. Answers to questions (1) – (4) should be provided on an Excell spreadsheet, using the format provided on the sample answer sheet. Proprietary information, including any information that could be used to identify a specific company, will be handled consistent with Iowa's Uniform Trade Secret laws and protections (Iowa Code section 22.7(3)). If your company seeks this protection, please clearly state your request in your response. Also inform the Division which answers your company specifically would like to hold confidential. Should your company have any questions or issues, please contact me at the numbers provided below. Thank you in advance for your assistance.

Sincerely,

Angel Robinson

Consumer Advocate

Iowa Insurance Division

330 Maple Street

Des Moines, Iowa 50319

Office: (515) 281-4038

Angel.Robinson@iid.iowa.gov

Fax: (515) 281-3059

Hypothetical Policyholder Information

Auto Insurance Policy

Liability 100/300/50
$100,000 per person for bodily injury
$300,000 per accident for bodily injury
$50,000 per accident for property damage

Collision $500 deductible
Comprehensive $500 deductible
No other coverages
No claims or violations
Car: 2005 Toyota Corolla S 4 dr sedan (1.8L 4 cyl 5M)
1 car, 1 driver
Principle driver drives to work 10 miles each way
Single, Male, aged 35 birthday: January 1, 1974
Address: 330 Maple, Des Moines, IA 50319
Polk County
No other discounts except as explicitly included in the above example.
6 months coverage (if only annual policies are offered, please divide the resulting premium by 2)
Prior insurance at same limits and coverage

Homeowners Insurance Policy

Premiums that were in effect January 1, 2008
Single 35 year old male
Coverage A (Dwelling) $150,000
Coverage B (Detached other structure) $30,000 30x30 detached garage built in 1990
Coverage C (Contents) $100,000
Coverage D (Loss of Use) Actual loss sustained for 12 month period after the loss
Coverage E (Personal Liability) $100,000
Coverage F (Medical payments to others) $1,000
$500 deductible no separate wind/hail deductible
Address: 330 Maple, Des Moines, IA 50319
Polk County
Building: 1 story ranch, frame construction, 2,500 square feet built 1990, 4 bedrooms, the electrical, HVAC, plumbing and roof are original. Home has an unfinished basement.
Metal siding, concrete block foundation, asphalt shingle, gable roof for both the dwelling and garage
Policy form is HO-3
Fire protection class 3
Replacement cost coverage for contents
No prior losses
Prior insurance
Smoke detectors, deadbolt locks
No pets/trampolines/etc
No other coverage

No discounts or surcharges other than as included above
If additional items are automatically included (like water damage), cannot be excluded, or have no price differentials, make no adjustments for them. If there are price differentials, but the items cannot be excluded completely, use the lowest cost option that is available for all policies.
If additional coverage is available only for certain tiers, please explain.
1 year coverage

Sample Answer Sheet

Q1-Totals

Home	Auto
20,000	30,000

Q2 - Levels

Home	Auto
L1 - 5,000	L1 - 5,000
L2 - 5,000	L2 - 5,000
L3 - 5,000	L3 - 5,000
AC/IC - 5,000	L4 - 5,000
	L5 - 5,000
	AC/IC - 5,000

Q3 - Scores

Home Min	Home Max	Home Average	Auto Min	Auto Max	Auto Average
L1 - 900	L1 - 1000	L1 - 950	L1 - 950	L1 - 1000	L1 - $ 500
L2 - 700	L2 - 800	L2 - 750	L2 - 850	L2 - 900	L2 - $ 500
L3 - 500	L3 - 600	L3 - 550	L3 - 750	L3 - 800	L3 - $ 500
AC/IC - L2	AC/IC - L2	AC/IC - L2	L4 - 650	L4 - 700	L4 - $ 500
			L5 - 550	L5 - 600	L5 - $ 500
			AC/IC - L3	AC/IC - L3	AC/IC - L3

Q4 - Pricing

Home Min	Home Max	Home Differential	Home Hypo	Auto Min	Auto Max	Auto Differential	Auto Hypo
L1 - $ 100	L1 - $ 500	L1 - $ 400	L1 - $ 600	L1 - $ 100	L1 - $ 600	L1 - $ 500	L1 - $ 700
L2 - $ 200	L2 - $ 600	L2 - $ 400	L2 - $ 700	L2 - $ 200	L2 - $ 700	L2 - $ 500	L2 - $ 800
L3 - $ 300	L3 - $ 700	L3 - $ 400	L3 - $ 800	L3 - $ 300	L3 - $ 800	L3 - $ 500	L3 - $ 900
AC/IC - $ 200	AC/IC - $ 600	AC/IC - $ 400	AC/IC - $ 700	L4 - $ 400	L4 - $ 900	L4 - $ 500	L4 - $ 1000
				L5 - $ 500	L5 - $ 1000	L5 - $ 500	L5 - $ 1100
				AC/IC - $ 300	AC/IC - $ 800	AC/IC - $ 500	AC/IC - $ 900

D. Appendix 3B: Public Hearing Information

Public Hearing:

Use of Credit in Insurance

Saturday, May 30, 2009
10:00 am – 12:30 pm
Iowa State Capitol Building, RM 116

Agenda

I. Opening of Hearing
   a. Introduction of Consumer Advocate / Presenter

II. Presentation: Credit Scores Use in Insurance in Iowa
   Ramona Lee, Iowa Insurance Division

III. Consumer Testimony and Comment

IV. Insurance Industry Testimony
   a. Questions and Comments from Consumers and Consumer Advocate

V. Closing of Hearing
   a. Announce opportunity to submit written testimony to supplement public statement

Meeting Minutes

Public Hearing: Use of Credit Scores in Insurance

May 30, 2009 (10:00 am – 12:30 pm)

The public hearing on the use of credit in insurance commenced at 10:00 am at the Iowa State Capitol Building, room 116 on Saturday May 30, 2009. Iowa Insurance Division representatives present included Angel Robinson, Consumer Advocate, Ramona Lee, Actuarial Administrator, and Tom O'Meara, of the Market Regulation Bureau. Additionally present were six consumers, one representative from the Iowa Independent Insurance Agents, and eleven representatives of the insurance industry.

I. Opening of Hearing

Angel Robinson, Consumer Advocate, opened the public hearing with the introduction of herself and Ramona Lee, Actuarial Administrator as members of the Iowa Insurance Division staff. Ms. Robinson informed those present that the purpose of the public hearing was to provide consumers with an opportunity to hear about the topic from experts and to provide a venue for consumers to express their opinions and thoughts on the subject. Consumers were asked to sign in if they were willing to do so. Ms. Robinson presented the agenda of and introduced the presentation by Ms. Lee about how insurance scoring in Iowa.

II. Presentation by Ramona Lee, Actuarial Administrator: Credit Scores use in Iowa (PowerPoint presentation attached).

Ms. Lee explained the purpose of her presentation is to explain how insurance scoring is currently used in Iowa today. Ms. Lee explained her job at the Iowa Insurance Division is to review rates used by property/casualty insurers authorized to do business in Iowa. A review of rates requires assuring that the proposed premiums charged are fair and reasonable for the coverage provided. Iowa's current law has been in effect since 2004. Ms. Lee then explained insurance scores and defined them. Insurance score is defined as a number or rating that is derived from an algorithm, computer application, model, or other process that is based in whole or part on credit information for the purposes of predicting the future insurance loss exposure of consumers. Insurance scores are used in personal insurance and regulated by the Fair Credit Reporting Act and Iowa Code sections 515.103, 515.4, 515.5, and 515.24. Ms. Lee then explained that insurance scores are used in underwriting to determine if an insurance company will give you a policy and if so, which affiliated company would have your policy. For rating, an insurance score could be added to premium totals with other factors. When calculating an insurance score the factors of income, gender, address, zip code, ethnic group, religion, marital status, race, and nationality are not permitted to be used for calculating insurance scoring.

Insurance scores are considered to be a trade secret, but rate filings (the calculations of how your rate is determined) are available for public viewing. Ms. Lee explained that adverse action notifications must be sent to consumers. The adverse notifications must state the reasons behind the adverse action. Ms. Lee also explained that credit information cannot be the sole basis to deny, cancel, refuse to renew, or base renewal rates upon. It was also explained that insurers must notify consumers that credit information will be reviewed. Restrictions are additionally placed on the use of incomplete or incorrect credit information and the age of credit information. Ms. Lee explained that some credit inquiries may not be used. These inquiries included inquiries: for the consumer's own information, not initiated by the consumer, related to insurance, medical collections, and multiple inquiries for home and automobile lending within the last month. Ms. Lee shared that insurers must treat consumers with an absence of credit (or where there is an inability to calculate an insurance score) as neutral in rating a policy. Ms. Lee concluded by explaining that there are other factors besides insurance scores used to determine premium.

III. Summary of testimony from consumers: (There were six consumers present. Only four consumers volunteered to submit testimony. The testimony summaries are provided in the order given.)

Martha Reineke (written statement attached):

Ms. Reineke disagrees with the practice of insurance scoring. Ms. Reineke was notified that she had an "unfavorable number of open or revolving accounts", "recent delinquencies", "insufficient length of credit", and "too many credit checks" and as a result she would be moved to a more expensive tier. When Ms. Reineke contacted the credit reporting agency used, Ms. Reineke was told she had a high credit score that would be even higher if she had a mortgage on her home. Ms. Reineke rejects the idea that there is a correlation between her carefully planned finances and her level of risk. Ms. Reinek explained that she uses department credit cards for discounts but does not maintain a balance on any credit account as she pays off all her debt. Ms. Reinek also rejected the idea that a recent late payment could be accurate as a review of her credit report shows the only late payments (two) were three years ago and were due to the turnaround in mail time sent to a company on the east coast. Once it was discovered that making mail payments would result in late payments, Ms. Reineke did not use that card any longer. Ms. Reineke also said that her credit report was over 20 pages long and started in the 1970's so she disagrees that the length of her credit was insufficient. On the credit report received, Ms. Reineke found 2 inquiries from current credit card companies used to update their credit information on her; otherwise all of the other credit checks were unsolicited. Ms. Reineke objected to the fairness of being penalized for "promotional checks" that are not in her control. When Ms. Reineke attempted to get additional details about what is necessary for her to improve her insurance score, she was told this information was proprietary. Ms. Reineke believes that insurance scoring is "too blunt an instrument" and that it should be banned in Iowa. If it is not banned, the insurance scoring rubrics should be made available to the public so consumers can learn where they are deficient in their score. Transparency is necessary.

Doug Johnson:

Mr. and Mrs. Johnson wished to testify that their insurance went up because of their credit. The Johnsons explained that they had no claims, had been loyal customers, had a good credit score, and had paid off their vehicles and property. The Johnsons were notified that their insurance score had decreased and therefore their insurance premium would increase. Mr. and Mrs. Johnson asked their insurance company why and were told that they were more likely to file an insurance claim. The Johnsons disagreed with the insurance company because he and his wife had filed not claims and that the theory was not true. Mr. and Mrs. Johnson explained that they did not believe the statistics because it made no sense that their credit would be tied to filing an insurance claim. Mr. and Mr. Johnson believed the fact that they had no debt does not mean they will file more claims.

Angela Loy:

Ms. Loy explained that her story was personal. She had been laid off and her credit score had gone down. Ms. Loy explained that even though she had not filed any claims in decades her insurance went up because of her credit. Ms. Loy explained that she felt she was being punished for being laid off. Ms. Loy also expressed concerns that her increased insurance rate would cause her to have to make tough decisions on what bills and deciding what should be paid.

Charles Grove:

Mr. Grove shared that he was informed by his agent that he was not eligible for the best insurance rate as he didn't have a credit history. Mr. Grove explained that he paid with things in cash and that he didn't owe anything to anyone. Mr. Grove explained that he thought it was not right that he was not able to get the best rate just because he did not use credit. Mr. Grove explained that in an attempt to develop credit he tried to take out a credit card and was rejected because he did not have enough credit. Mr. Grove then explained that he had discovered that he would now have a negative mark on his credit because he had been rejected from getting a credit card in an attempt to get better insurance. Mr. Grove explained how he believes this process to be unfair for consumers like himself who did not have credit and did not use credit, but were rejected from getting the best rates.

IV. Individual insurance companies present declined to comment. Testimony was given by their trade group Property Casualty Insurers Association of America (PCI).

Alex Hageli, PCI Manager of Personal Lines:

Mr. Hageli explained the correlation between insurance scoring and claims. Mr. Hageli explained that studies had been done to demonstrate that when compared to historical data individuals with low scores were more likely to file claims. It was also explained that different companies use insurance scores different ways. Mr. Hageli pointed to other state and federal agencies that have concurred with industry findings such as the Department of Texas and the Federal Trade Commission. Mr. Hageli also explained that credit history is just one factor used by insurance companies.

Consumers again objected to the correlation to risk. Consumers also asked Mr. Hageli if consumers who did not use credit would be eligible for the best rates. Mr. Hageli informed those attending the hearing that the NCOIL model used by Iowa allows consumers with no credit to be treated neutrally. When asked about causation, Mr. Hageli explained that they don't know why but there is research that points to risky behaviors in one area of life going into others. Consumers and Mr. Hageli got into a discussion about what information is available from consumer reporting agencies. Ms. Robinson suggested that this was an issue that will not be agreed upon and the third party vendors who are responsible for this area are not present. Ms. Robinson informed those at the hearing that the credit reporting agencies and the model scoring agencies would be invited to participate in an upcoming hearing and the question could be accurately answered at that time.

V. Summary of closing remarks from Consumer Advocate

Ms. Robinson thanked all the consumers who were willing to share their opinions and personal stories. The consumers were also thanked for coming out on their weekend. Ms. Robinson thanked Ms. Lee for her presentation and Mr. Hageli for his willingness to participate. Consumers were encouraged once again to submit their testimony in writing for the record. The reminder was given that a second public hearing would be held on June 2, 2009. Once more the meeting would take place at the Capitol but in room 103 and would begin at 4:00 pm.

Credit Scores

Use in Insurance in Iowa

Ramona C. Lee
Iowa Insurance Division
5/30/2009 10:00 a.m.

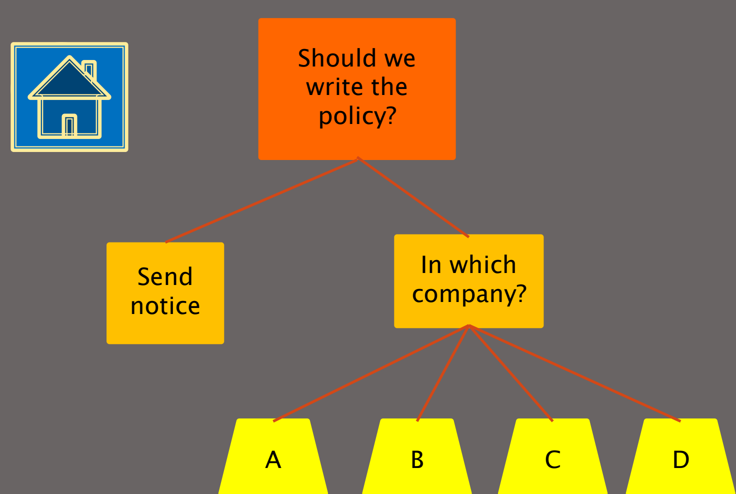
"Insurance Score"

bankruptcy	No	0	
	Yes	5	5
# of credit cards	0-2	3	
	3-4	0	0
	5 or more	5	
tickets	none except	0	
	speeding**	4	4
	drunk driving	10	
sum			9
Multiply by 80			720

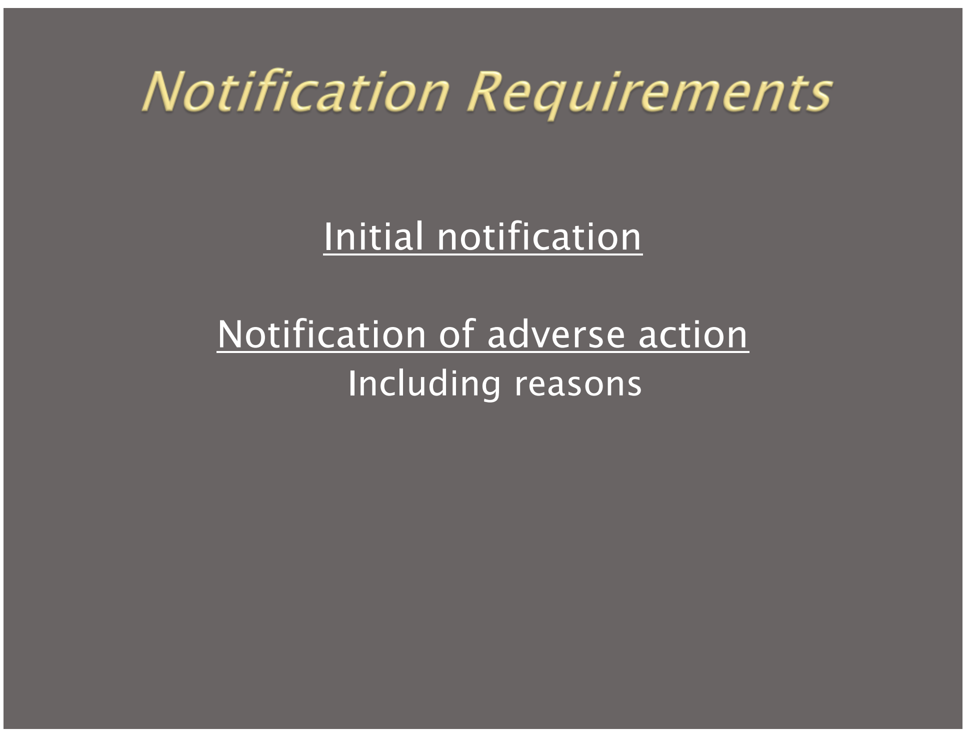
Regulation

- Federal Fair Credit Reporting Act
  15 U.S.C. § 1681
- Iowa Credit Law for Personal Insurance
  515.103
- Iowa Rating Laws
  515.4, 515.5, 515.24

Underwriting




Premium
Base Rate
Des Moines $200
Elsewhere $300
$200
Insurance Score
0-500 -10%
501-1000 0%
101-1600 +10%
+0% = $200
Construction
Glass 2.0
Stone 1.0
x 2.0 = $400
Loss Surcharge**
No losses 0%
Prior losses 100%
x 100% = $800


Notification Requirements
Initial notification
Notification of adverse action
Including reasons

Sole Basis

Cannot

Deny issuance
Cancel
Refuse to renew

Use as basis of renewal rates

solely based on credit information

Disclosure and Dispute Resolution

- Disclose use in underwriting or rating
- Re-underwrite or re-rate if incorrect or incomplete information corrected
- Age of credit information used

Prohibited Factors

Insurance Scores	Rating Factors
Income	Race
Gender	Creed
Address	National Origin
Zip code	Religion
Ethnic group	
Religion	
Marital status	
Race	
Nationality	

Credit Inquiries

those that may not be used as negative factors

- Not initiated by consumer
- For consumer's own information
- Relating to insurance coverage
- Medical collections
- Multiple inquiries for
  - Home mortgages
  - Automobile lending

** if so identified

No Hits

absence of credit information
inability to calculate an insurance score

Underwriting

- Exclude credit information
- Only use other criteria

Rating

- Treat as if neutral credit information
- Defined by the insurer

Rate Filings

Competitive markets

Filings by companies and rating agencies

Trade Secret

Other Rating Considerations

- Minor Traffic Violations
- Catastrophe Loss Surcharges

Resources

- Iowa Insurance Division
- www.iid.state.ia.us
  515-281-5705 or Toll Free 877-955-1212

- Ramona C. Lee, Actuarial Administrator
- Ramona.Lee@iid.iowa.gov
  515-281-4095

- Iowa Code
- www.legis.state.ia.us
  - 515.103
  - 515F.4, 515F.5, 515F.24

- Federal Fair Credit Reporting Act
- www.ftc.gov
  - 15 U.S.C. § 1681

[Submitted Public Hearing Testimony from Martha Reineke]

Hello. My name is Martha Reineke. I live in Denver, Iowa and have been employed for the last twenty-five years as a professor of religion at the University of Northern Iowa. I appreciate this opportunity to bring a consumer's perspective to the use of insurance credit scores in assigning rates for home insurance in Iowa. Although my insurance company, Horace Mann, has been using credit scores for seven years, I learned of this practice only in April, when I found enclosed with my renewal a notice that my rate has been affected by my insurance credit score. I was informed that I am a Tier 2 rather than Tier 1 client because I have (quote) "an unfavorable number of open or revolving accounts." I was stunned to see myself as Horace Mann apparently sees me: a spendthrift wallowing in an ocean of Visa card debt. If my rates had gone up because of our recent claims—two roofs in ten years because of hail damage—I would not have been surprised. But to be informed that my rate is negatively impacted because of the number of credit cards I own is astonishing. That is why I am here today.

Horace Mann tells me that "the exact components of the Fair Isaac insurance scoring model they use are proprietary." As a consequence, I do not know how many credit cards over the acceptable number I possess or if I would harm or help my score and therefore my insurance rates by canceling some of the cards. When I contacted TransUnion, the company from which Fair Isaac receives the data that they use to create my insurance score, TransUnion told me my credit score is an A rating: 948 out of 990 possible points. The primary reason it is not higher is that I have no home mortgage reported to TransUnion. TransUnion has no concerns about the number of credit cards I own. I would like to address two aspects of the situation I have just described.

First, I challenge the insurance industry's claim that there is a correlation between a client's credit score and their risk. The letter I received from Horace Mann said that persons who are conscientious about their personal finances take better care of their property. Apparently my 16 credit cards mark me as someone less likely to take care of my property than someone with fewer cards. But the Fair Isaac insurance scoring model is flawed because it has been unable to detect that actually I am extraordinarily conscientious in my use of money. TransUnion does not track credit balances. Therefore, in using TransUnion data to calculate my insurance score, Fair Isaac has not considered key evidence that I am a careful financial manager: with the exception of a car payment, I pay off all my balances every month. The Fair Isaac insurance scoring model is such a blunt instrument of analysis that it is unable to fairly account for how I use my credit cards. The cards are for stores such as Kohl's, LL Bean, and Talbot's which provide free shipping, coupons, and reward gift cards because I maintain a credit card with them. I use only two or three cards per month but I save hundreds of dollars a year in purchases for my family because of my prudent use of the benefits of my credit card ownership. If the Fair Isaac scoring model was truly fair, I would receive a bonus rather than a deduction in my insurance score because of how much money I save my family through my astute use of my credit card perks.

My second area of concern has to do with my quandary as a consumer about what to do about my insurance score if I want to improve it. Because the Fair Isaac Scoring Model is proprietary, I have not been able to obtain this information. Let me share an analogy with you. If I used the same approach to grading my students at UNI that my insurance company is using with its credit scoring, if a student asked me why she got a B on an exam and what she would need to change about her work in order to get an A on the next exam I would tell her that I use the Fair Professor Scoring Model. However, because it is a proprietary model I would tell the student that I can not divulge to her any specific information about the criteria I use that would enable her to make changes in her work in order to earn an A in the future. I hope you agree with me that I should not consider my grading criteria proprietary knowledge. As a matter of fact, in my work as a professor, I use a detailed grading rubric so that students know exactly the criteria on which I will be grading their written work and can clearly see what they need to do to more closely approximate those criteria on future tests. I think that the insurance industry should be required to be as accountable and transparent in their scoring as I am in scoring my students.

I recommend that insurance credit scoring not be allowed in Iowa. Based on the issues I have described, insurance scoring is altogether too blunt an instrument because it has been wholly unable to detect my exemplary record of responsible financial management. But if scoring is to be permitted, the insurance companies need to be held accountable for that scoring. Their scoring rubrics should be accessible to the public so that consumers can see exactly where we fall short and can learn how we can specifically redress deficiencies or contest our scores. In the absence of that level of transparency and accountability the insurance industry is doing consumers a disservice.

Late yesterday I received a communication from the assistant vice president and council at Horace Mann who was concerned about my testimony today. She advised me that being a Tier 2 Horace Mann client is actually a very good ranking. To return to my teaching analogy: when a B student comes to my office and asks what she can do to become an A student, I don’t tell her that a B is actually a very good grade, thereby second-guessing her concern. Instead, I give her information that will help her become an A student. My point still stands: whether a consumer is assigned to a high or low tier by an insurance scoring model, the use of credit scores in the insurance industry should not be permitted in Iowa unless the industry is willing to bring transparency and accountability to the scoring models that it uses.

Paragraph below was not read at the hearing due to time constraints:

That the Fair Isaacs scoring model is flawed is also shown by three additional negative factors cited from my insurance score. These did not appear on my renewal form but were included in a letter from Horace Mann when I complained. The letter noted "recent delinquency." By this they were referring to two late payments three years ago. I stopped using that particular card when I realized that I had missed two payment dates because the bank offices were located out east and by the time I got their notice and returned it the turnaround time was less than two weeks. Two late payments in over ten years of credit history is hardly a record of problematic delinquency. The letter also said that I had an "insufficient length of credit history" even though my TransUnion credit report lists my oldest credit card, which I got in 1979, the year I got married, and shows cards added through the 1980s and 1990s. The report is almost twenty pages long! Horace Mann also said that I had "too many recent credit checks." There were 42 credit checks listed on my credit report – two were for updates on credit cards from LL Bean and Talbots, both of which wanted to upgrade my card status to add more benefits. The other checks were unsolicited "promotional checks" (identified as such on my credit report) from companies such as Discover and American Express who are looking for customers. Unless the Fair Isaac scale judges that two credit checks associated with an upgrade are "too many credit checks," they are unfairly and illegally penalizing me for promotional inquiries. The Fair Isaac scoring scale appears to have some serious problems. Greater transparency in the Fair Isaac scoring scale is very much needed in order to identify these deficiencies, if my experience is representative.

Public Hearing:
Use of Credit in Insurance

Monday, June 29, 2009
4:00 pm – 6:00 pm
Iowa State Capitol Building, RM 103

Agenda

I. Opening of Hearing
   a. Introduction of Consumer Advocate and Presenter
II. Presentation:
   a. Consumer/Consumer Advocate questions on presentation
III. Question and answer session with credit based insurance score model companies FICO and Transunion
IV. Consumer Testimony and Comments
V. Close of Hearing
   a. Announce date of last public hearing on insurance scoring

Meeting Minutes

Public Hearing: Use of Credit Scores in Insurance

June 29, 2009 (4:00 pm – 6:00 pm)

The public hearing on the use of credit in insurance commenced at 4:00 pm at the Iowa State Capitol Building, room 103 on Monday, June 29, 2009. Angel Robinson, Consumer Advocate, was present representing the Iowa Insurance Division. Additionally present was one member of the public, two representatives from insurance scoring model companies, and six representatives of the insurance industry.

I. Opening of Public Hearing

Angel Robinson, Consumer Advocate, opened the public hearing with the introduction of herself and presenter Lamont Boyd of FICO. Ms. Robinson informed those present that the purpose of the public hearing was to provide consumers with an opportunity to hear about the topic from experts and to provide a venue for consumers to express their opinions and thoughts on the subject. Consumers were asked to sign in if they were willing to do so. Ms. Robinson presented the agenda and introduced the presentation by Mr. Boyd. FICO was requested to be present to clarify what role scoring model agencies play in the chain of insurance scoring and to speak on what factors are considered in insurance scores.

II. Summary of the presentation by Lamont Boyd, Director of Insurance Market, FICO Scoring Solutions (PowerPoint presentation attached).

Mr. Boyd explained that scoring models had moved from mortgages and lending, to providing trend and scoring information for other areas such as insurance. One of the most common questions FICO has been receiving lately is that of scoring model's effectiveness in the current markets. Mr. Boyd explained that there have not been dramatic changes in scores and that generally they have remained stable. CBIS scores (FICO's version of insurance scores) have shown a slight increase in the past few months. Mr. Boyd stressed that the trends are constantly tracked to maintain accuracy in the market.

Speaking of insurance scoring generally, Mr. Boyd reiterated that insurance scoring has been studied and found legitimate by the FTC and other actuarial studies. Mr. Boyd shared that insurance scores are objective, accurate, benefit the most consumers, they are independent of demographic groups, and income levels. Mr. Boyd explained that insurance scores measure the management of credit obligations and that restrictions on the use of insurance scores would result in higher rates for better risks. Mr. Boyd shared the five major areas measured for predictability. At forty percent, payment history is reviewed including delinquencies. Thirty percent is based on outstanding debt. Outstanding credit includes how much debt does the consumer have, how much credit is available, and the percentage of open installment loans. Fifteen percent focuses on credit history length. This includes the number of months since the opening of a new account, the average number of months an account has been open, and how old is the consumer's oldest account. Ten percent of the models will focus on the pursuit of new credit (permissible inquiries). Credit mix is five percent of what is reviewed. Credit mix includes what types of credit products are used, the number of bankcards for trade lines, and the percent of trade lines that are installment loans.

Mr. Boyd closed by explaining there are education opportunities for consumers to learn how to improve their scores (lending and insurance) available on their website. Mr. Boyd also shared that an annual credit report may be requested as provided in the Fair Credit Reporting Act.

III. Summary of question and answer session with FICO and Transunion. Lamont Boyd, Director of Insurance Market, represented FICO Scoring Solutions and Eric Rosenberg, Director of State Government Relations represented Transunion LLC, a scoring company as well as one of the three national major credit reporting agencies.

Ms. Robinson asked where in the insurance scoring process would a consumer contact a scoring model company or a credit reporting agency. Mr. Boyd explained that FICO had no direct contact with consumers. FICO only analyzes credit information and forms a score that is provided to the insurance companies. Mr. Rosenberg explained that Transunion is a scoring company and a credit reporting agency. Mr. Rosenberg explained that consumers can contact a credit reporting agency when they have questions about the contents of their credit reports. Ms. Robinson inquired if consumers are told exactly what can be done to improve their insurance score. Mr. Rosenberg explained that credit reporting agencies cannot provide specific reasons an adverse action was taken. Only the top four reasons are provided by a scoring company as to why an adverse action was taken. Ms. Robinson asked Mr. Boyd to verify that the top reasons for adverse action are provided by the scoring companies, but there is no communication between consumers and the model companies. Mr. Boyd verified that FICO does not work directly with consumers. Ms. Robinson asked Mr. Boyd and Mr. Rosenberg to verify the following insurance scoring chain:

Credit reporting agency sends credit reports (from Transunion, Equifax, Experian) →to insurance scoring companies (example: FICO) that create an insurance score number that is sent to → insurance companies that incorporate the insurance score into the underwriting and rating for a consumer. Information is shared with consumer and if there is a complaint the insurer sends the consumer → to the credit reporting agency for questions and issues with credit. Mr. Boyd and Mr. Rosenberg verified that was correct.

Ms. Robinson asked Mr. Rosenberg if Transunion provides explanations of adverse action reasons to educate the consumer on ways to improve their insurance scores. Mr. Rosenberg explained this information is shared with consumers who ask. Ms. Robinson asked what consumer education is provided on insurance scoring. Mr. Boyd shared that there was information available on the FICO website.

IV. Consumer Testimony and Comment

Mr. Charles Grove was the only consumer present. Mr. Grove was present for the first public hearing on credit scores in insurance and declined to make additional comments as he felt his position had been made clear at the previous hearing.

V. Closing remarks by Consumer Advocate

Ms. Robinson thanked Mr. Boyd and Mr. Rosenberg for coming to explain their companies' part in the insurance scoring process. Mr. Grove was thanked for his attendance once again. Ms. Robinson made a reminder announcement that the last Public Hearing will be on September 16, 2009, in the same room, starting at 4:30.

FICO® Credit-Based Insurance Scores
Score Trends in Dynamic Times

Lamont Boyd, CPCU, AIM
Director, Product Management
FICO

June, 2009

FICO

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Agenda

FICO

» Credit Conditions Impacting Scoring Trends
» FICO® CBIS Models
» Best Practices

2

FICO

Credit Conditions Impacting Scoring Trends

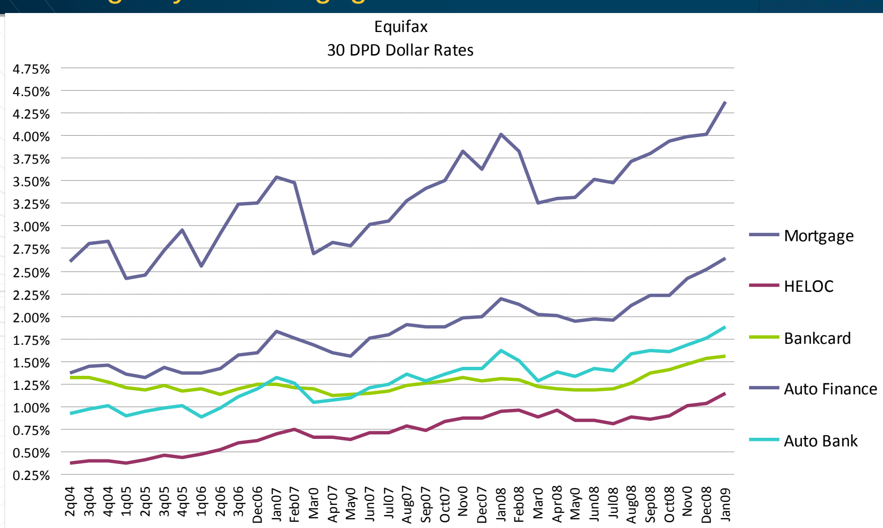
» Delinquency Trends

» FICO® CBIS Score Impacts

3

Evolving Beyond Mortgage

FICO



» Early stage 30 DPD dollar rates influence late stage dollar delinquency and major derogatory rates.

» Bankcard delinquencies did not begin to rise until 2nd half of 2008.

» 30 DPD dollar rates continue to increase for all major industries in January 2009.

4

Impact on FICO® CBIS Score Trends

Common questions:

»Have FICO® CBIS score distributions changed over time?

»Do FICO® CBIS scores continue to effectively rank-order risk under current market conditions?

5

Tracking CBIS Score Distribution Trends

- » Based on national samples spanning 2006–2008
  - » Score distribution is stable over time at national and state levels
  - » Very slight increase in average CBIS scores in recent months

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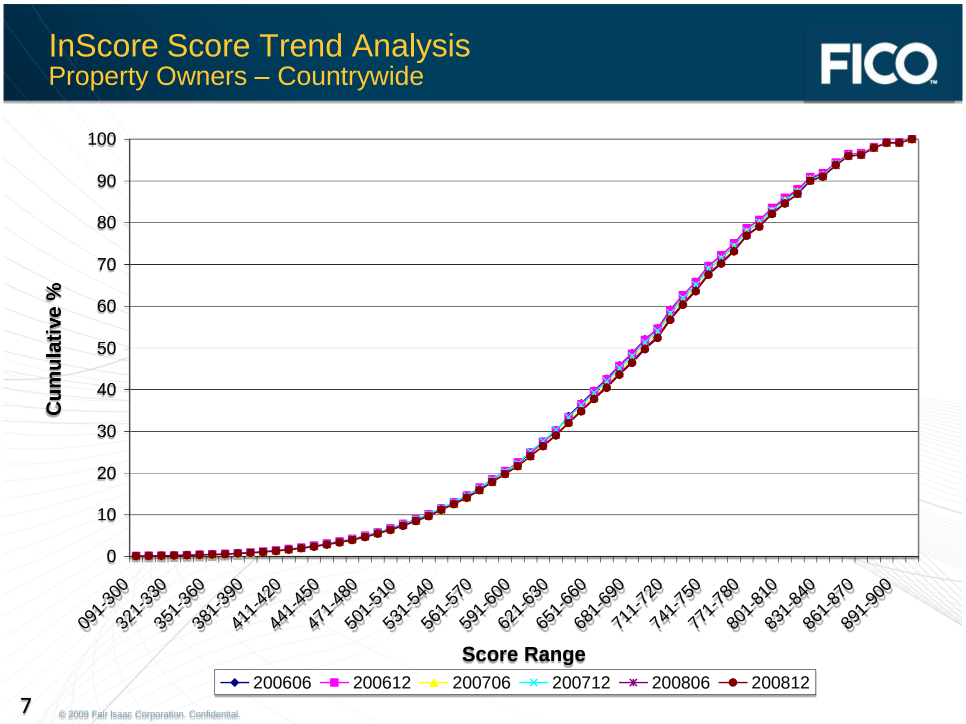

InScore Score Trend Analysis
Property Owners – Countrywide
FICO
Cumulative %
Score Range
200606
200612
200706
200712
200806
200812
7
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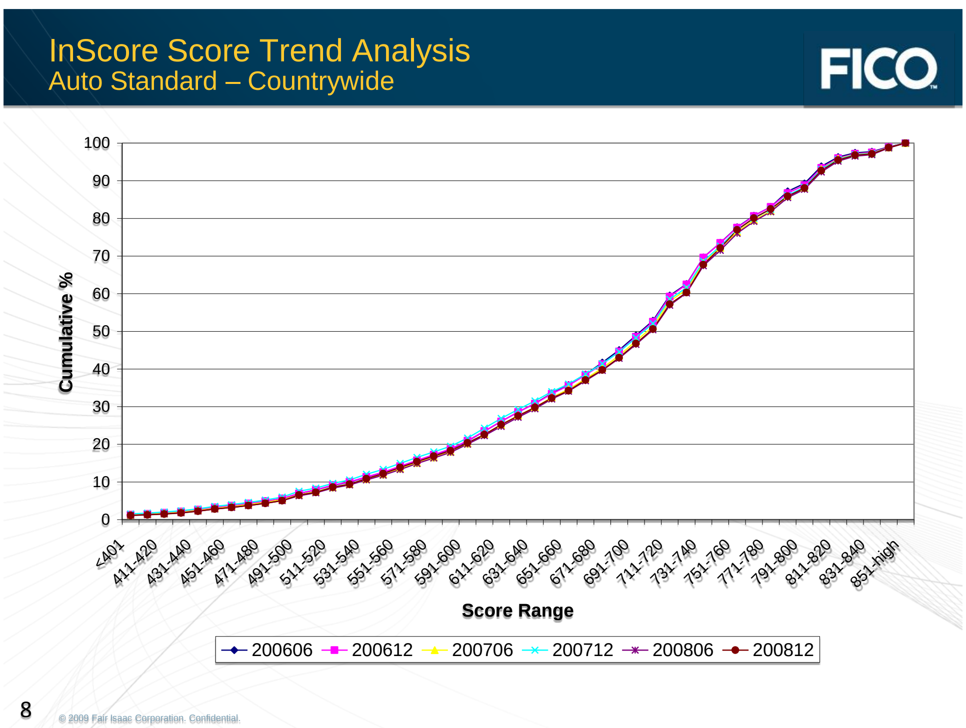

InScore Score Trend Analysis
Auto Standard – Countrywide
FICO
Cumulative %
Score Range
200606
200612
200706
200712
200806
200812
8
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Tracking CBIS Score Trends

FICO

» CBIS score distributions – expected to move and shift some
  » Reflect changes in data reporting, national and regional economic impacts, credit management practices

» CBIS score predictive power
  » Consistently rank-orders various insurance populations over time
  » Ongoing monitoring and analysis

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FICO

FICO® CBIS Models

» Introduction and Utilization
» Validity and Value Proven
» Predictive Characteristics

10

Insurance Scoring Studies

- » CBIS validity and value proven repeatedly
  - » FICO
  - » Independent actuarial and regulatory studies
  - » FTC Auto Study – July, 2007
    - » CBIS scores are objective tools for more accurate risk evaluation
    - » Use of CBIS scores benefits most consumers
    - » CBIS scores cannot be used to identify demographic groups
    - » CBIS scores are not correlated to income levels but to an individual's management of credit obligations
    - » Restricting CBIS scores would result in higher rates for better risks – without regard to race and ethnicity

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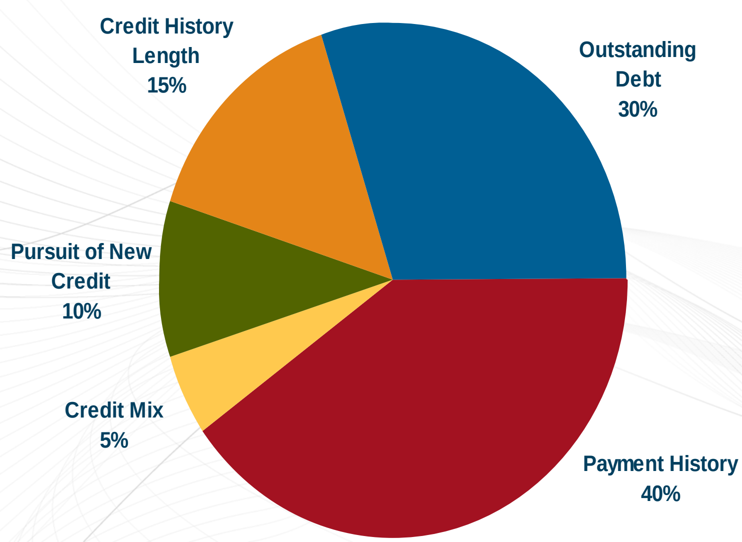
FICO® Credit-Based Insurance Scores
Five General Areas of Predictive Information



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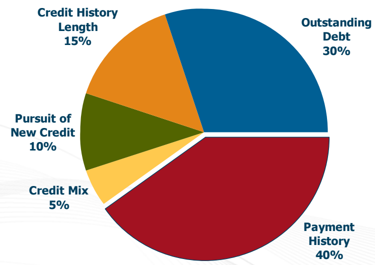
CBIS Predictive Characteristics
Payment History

Key Factors:

- » How recent is the most recent delinquency, collection or public record item?
- » How severe was the worst delinquency - 30 days, 90 days?
- » How many credit obligations have been delinquent?



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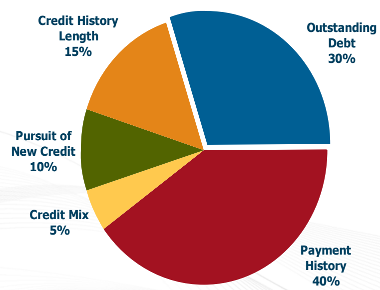
CBIS Predictive Characteristics
Outstanding Debt

Key Factors:

- » How much does the consumer owe creditors?
- » What percentage of available credit card limits is the consumer using?
- » What percentage is outstanding on open installment loans?



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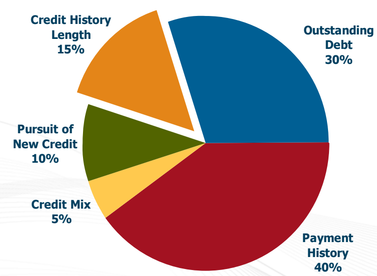
CBIS Predictive Characteristics
Credit History Length

FICO

Key Factors:

- » How long have accounts been established - average number of months accounts have been open
- » New accounts - Number of months since most recent account opening
- » Old accounts – Number of months since oldest account opening



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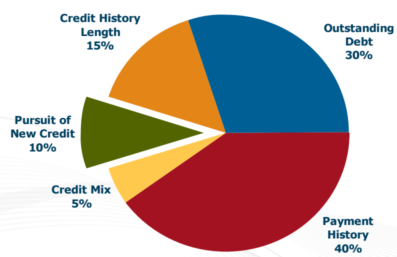
CBIS Predictive Characteristics
Pursuit of New Credit

FICO

Key Factors:

- » Inquiries: Number of recent inquiries (12 months)
- » New accounts - Number of trade lines opened in last year



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Types of Inquiries

FICO

» CBIS scores only consider consumer-initiated, credit-seeking inquiries posted in the last 12 months

» CBIS scores do not consider the following inquiries:

  » Promotional inquiries
  » Account review inquiries
  » Consumer disclosure inquiries
  » Insurance inquiries
  » Employment inquiries

» CBIS scores have 30-day de-dupe for auto and mortgage loan inquiries

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CBIS Predictive Characteristics
Credit Mix

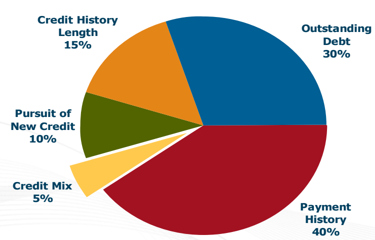
FICO

Key Factors:

» What is the mix of credit product types?

» Revolving credit – number of bankcard trade lines

» Installment credit – percent of trade lines that are installment loans



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Information Not Considered by FICO® Credit-Based Insurance Scores

FICO

- » Race, color, national origin
- » Religion
- » Gender
- » Marital status
- » Age
- » Income, occupation or employment history
- » Location of residence
- » Any interest rate being charged
- » Child/family support obligations or rental agreements
- » Certain types of inquiries
- » Whether or not a consumer is participating in credit counseling of any kind
- » Any information that is not proven to be predictive of future performance
- » Any information not found in the credit report

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FICO

Best Practices

- » Ongoing Monitoring and Tracking
- » Educational Materials

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Best Practices During Economic Uncertainty

- Consider impact of current market trends
  - Mortgage delinquencies, foreclosures, unemployment rates, bankruptcies, loan modifications on consumer credit
  - Impact on FICO® CBIS score will depend on:
    - How information is reported
    - Other factors in consumer's credit profile

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For More Information

- Education to help consumers understand and change habits to influence credit-based insurance scores is available at www.insurancescore.com
- Education to help consumers understand and improve their credit habits to influence the FICO® scores lenders use is available at www.myfico.com
- Under the 2003 Fair and Accurate Credit Transactions Act (FACT Act), consumers can access each credit report annually via www.annualcreditreport.com

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THANK YOU

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June, 2009

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FICO® Credit-Based Insurance Scores

1. Most consumers benefit from the use of insurance scores—

Lower premiums—In its July 2007 report, "Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance," the Federal Trade Commission noted "if credit-based insurance scores are used, more consumers (59%) would be predicted to have a decrease in their premiums than an increase." According to insurers, up to 75 percent of their policyholders pay lower premiums because of the insurers' use of credit-based insurance scoring within their underwriting process.

Objective and timely decisions—The use of scoring enables insurers to make more accurate, objective, consistent and timely underwriting and pricing decisions. Insurance scores are snapshots of consumers' insurance risk based on information in their credit report that reflects their credit-payment patterns over time, with more emphasis on recent information. An insurance score is the result of an objective, statistical analysis of credit report information identifying the relative likelihood of an insurance loss, based on the actual loss experience of individuals with similar financial patterns.

Most consumers have good scores—Most consumers manage their credit obligations well over time and so have good scores. Insurance scoring helps identify those consumers who present lower risk of loss so insurers can offer them lower insurance premiums. This helps to make insurance coverage more available and affordable to the majority of consumers.

2. Correlation between credit behavior and insurance risk has been proven—

FTC concludes these scores are effective risk predictors—In its July 2007 report, "Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance," the Federal Trade Commission said, "Credit-based insurance scores are effective predictors of risk under automobile policies. They are predictive of the number of claims consumers file and the total cost of those claims. The use of scores is therefore likely to make the price of insurance better match the risk of loss posed by the consumer."

Independent studies agree—Separate studies by the Texas Department of Insurance (TDI), the University of Texas, Tillinghast Towers-Perrin, EPIC Consultants and others have proven that credit-based history correlates with the risk of insurance loss. The recent TDI study showed that: *(source: Insurance Information Institute, January 2005)*

- The average loss per vehicle for people with the worst insurance scores is double that of people with the best credit-based insurance scores.
- Homeowners insurance loss ratios for people with the worst insurance scores are triple that of people with the best scores.
- Drivers with the best credit history are involved in about 40 percent fewer accidents than those with the worst credit history.

Scores are based on most accurate data—The data at credit bureaus is one of the most accurate sets of consumer data available to insurers. Based on studies, the error rate in credit reports is considerably lower than the error rate found in motor vehicle records.

3. **It's common sense that credit habits relate to insurance risk**—

Overall behavior is consistent—In general, people with good credit habits demonstrate careful behavior overall. This crosses over into their driving habits, care of their automobiles, and care taken in the maintenance and safety of their homes.

4. **For insurers the issue is risk, not race—**

FTC finds scores are not a proxy for race—In its July 2007 report, "Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance," the Federal Trade Commission wrote, "Credit-based insurance scores appear to have little effect as a 'proxy' for membership in racial and ethnic groups in decisions related to insurance. ...Tests also showed that scores predict insurance risk within racial and ethnic minority groups. ...This within-group effect of scores is inconsistent with the theory that scores are solely a proxy for race and ethnicity."

Scores are color-blind and objective—An independent study by the Texas Department of Insurance confirmed that credit-based insurance scoring does not discriminate racially or by income. According to that study, a higher percentage of adults in low-income groups and certain minority groups (African-American and Hispanic) have somewhat lower scores compared with the rest of the adult population. However, the study also showed that each group studied receives the full range of insurance scores. This is possible only if insurance scoring is a color-blind, objective process.

5. **Scores remain an effective tool during current economic conditions**—

Scores have shown to be very stable—In recent countrywide studies of FICO® Credit-Based Insurance Scores, the average scores have remained virtually the same for the general population. This is especially noteworthy during an economic downturn when the number of people who are delinquent in repaying creditors has clearly grown. We suspect the overall stability of these scores may be caused by a greater number of consumers making certain to pay all bills on time, paying down outstanding balances, and perhaps not seeking more credit obligations. In a word, more and more consumers appear to be realizing the value of prudent financial and credit management practices.

Scores may decline for those directly impacted—As a small but growing number of consumers have experienced recent financial hardships, such as mortgage foreclosures, it is impossible to generalize about the impact of such an event on an individual's credit-based insurance score. In each case the scoring formula considers the interrelationship of all credit information in each consumer's credit report, including any foreclosure information reported to the credit reporting agency.

Scores may change when lenders reduce credit limits:

- FICO® Credit-Based Insurance Scores assess a wide variety of data on credit reports, so the impact to the score from a single factor like credit limit reductions will depend on what other data is on the credit report and the amount of line reduction taken by a lender. The consumer's score could be unchanged, it could go down, or in some cases it could go up in combined response to other changes on the credit report.
- Our ongoing research indicates that lenders have reduced the revolving account limits for a relatively small percent of the population, and those line reductions have been a relatively small amount for that population.
- An important FICO principle is to let data—rather than judgmental factors—drive any changes to our CBIS scoring models. Our most recent score performance studies indicate that our scores continue to appropriately rank-order consumers based on insurance risk.
- While credit card holders don't control their credit limits, in many cases, they do control their account balances. Recent data shows that a notable number of consumers have reduced their revolving credit usage, helping to minimize any effect from lenders reducing their account limits.
- FICO plans to periodically analyze this credit industry activity and potential impact on our credit-based insurance scores going forward.

6. **FICO® Credit-Based Insurance Scores are fair to consumers**—

Evaluate only statistically-proven data—Our insurance models are built with only depersonalized data and our scores evaluate only credit-related information from consumer credit reports. They do not consider the person's income, age, marital status, gender, race, ethnic group, religion, nationality or location. People who are in identical situations would be charged the same amount for auto or homeowners insurance, irrespective of differences in race, ethnicity or levels of income, under a rating plan that permits the use of credit-based insurance scores in underwriting.

Support anti-discrimination laws—U.S. law requires businesses to avoid deliberate bias against minority groups. Through the use of insurance scoring, only individual consumers who represent potentially higher risk pay higher premiums, regardless of their race or income.

Consumers gain control—Consumers with poor credit-based insurance scores can improve their scores by improving their credit habits. Better scores can lead to lower insurance premiums for most consumers.

7. **Use of insurance scoring helps stabilize and open the marketplace for consumers**—

   Competition is good for consumers—The use of insurance scores keeps the insurance marketplace competitive, resulting in the availability of lower prices, better service, and more choices for consumers. Underwriters gain opportunities to identify and write insurance for people who in the past they may have declined because of incomplete knowledge or information. Also, a good credit history can offset negative underwriting factors such as a poor driving record, thereby enabling someone to get insurance who might otherwise have been denied or charged more.

8. **FICO® Credit-Based Insurance Scores are different from FICO® credit-risk scores**—

   Predict very different things—While both types of scores use information from consumer credit bureau files, they predict very different outcomes. Credit-risk scores such as FICO® scores are built to predict the likelihood of delinquency or non-payment of credit obligations. Insurance scores, by contrast, are built to predict whether a consumer is likely to result in more (or less) insurance losses than the average consumer.

   Insurance scores apply to customer groups—Individuals can have low insurance scores without ever having filed an insurance claim. That's because insurance scores are applicable to customer groups. Consider that some teenage drivers will never have an accident. As a group, however, teenage drivers experience many accidents. Similarly, as a group, customers with low insurance scores tend to have more losses than those with high scores.

9. **Use of insurance scoring frees insurers to focus on exceptional cases**—

   More attention for people with unusual needs—Insurers use insurance scoring to help make routine underwriting and pricing decisions. This frees underwriters to spend more time helping applicants who have unusual situations or needs.

10. **FICO is committed to helping consumers obtain credit and insurance coverage fairly and affordably**—

Free educational resources—We have established web sites such as www.insurancescore.com and educational programs to help consumers become better informed about credit-risk and insurance scores. These programs explain the credit behaviors that will help consumers improve their scores.

Every score includes explanation—Each insurance score based on credit bureau data is accompanied by up to four (4) score reasons to help consumers identify where they may have lost points, again providing insight into how credit behaviors are impacting scores, approval potential and pricing. Consumers who believe these score reasons misrepresent their credit history can examine their credit reports and request investigation of any information that they find to be inaccurate or incomplete.

Opportunities to address issues—We encourage our clients to use scores responsibly. We also welcome opportunities to address scoring issues with credit grantors, insurance companies, regulatory and legislative bodies, consumer advocates, consumers and the media.

11. FICO recommends the following guidelines to help consumers manage their scores in either a stable or volatile economy—

Make *all* your credit and loan payments on time—The calculation of FICO® Credit-Based Insurance Scores weighs payment history more heavily than any other variable on your credit report. Making all your payments by their due date is a key ingredient for a good score. When money is tight, pay at least the minimum amount due on credit card debt to avoid being reported delinquent. Overdue bills can significantly lower your score, including unpaid non-medical debts sent to collection agencies.

Keep credit card balances low—Individuals with good scores come from every income level, and in tough times they tend to scale back their use of credit cards and pay down their debts. If your credit card balances are close to your credit limits, budget your finances to make debt reduction a top priority. Your indebtedness is the second most important factor for scores.

Open new credit cards or loans only when necessary—Opening new credit accounts may cause your score to go down so be cautious about taking on new debt. This includes thinking twice before opening a retail store card just to get an extra 10 percent off your current purchase.

Get your free annual credit report from each national credit reporting agency through www.AnnualCreditReport.com, and check your credit history carefully for errors. Contact the reporting agency if you spot an error so they can investigate it.

Public Hearing:

Use of Credit in Insurance

Wednesday, September 16, 2009
4:30 pm – 6:30 pm
Iowa State Capitol Building, RM 103

Agenda

I. Opening of Hearing
   a. Introduction of Consumer Protection
II. Testimony on Insurance Scoring:
   Birny Birnbaum, Center for Economic Justice
III. Consumer Testimony and Comments
IV. Close of Hearing
   a. Announce that all written testimony should be submitted before October 1, 2009

Meeting Minutes

Public Hearing: Use of Credit Scores in Insurance

September 16, 2009 (4:30 pm – 6:30 pm)

The public hearing on the use of credit in insurance commenced at 4:30 pm at the Iowa State Capitol Building, room 103 on Wednesday, September 16, 2009. Angel Robinson, Consumer Advocate, was present representing the Iowa Insurance Division. Additionally present were seven members of the public including one legislator, one consumer protection organization representative, one member of the Independent Insurance Agents, and a dozen members of the insurance industry.

I. Opening of Hearing

Angel Robinson, Consumer Advocate, opened the public hearing with reviewing the agenda and the introduction of Mr. Birnbaum who requested to present testimony on behalf of consumer protection groups on the topic of insurance scoring.

II. Summary of the testimony from Center for Economic Justice by Birny Birnbaum (written statement included):

Mr. Birnbaum supports a ban on insurance scoring. Mr. Birnbaum expressed that insurance scoring is unfair, it is influenced by negative life situations, it is arbitrary and contrary in its results, it discriminates against protected classes, and it goes against the principles of insurance. It was shared by Mr. Birnbaum that insurance scoring is not needed and is not used in multiple states. California was given as a positive example of a state that rejected the use of insurance scores but maintain a competitive environment.

Mr. Birnbaum then discussed the meltdown of the economy due to an economic recession. There has been an increase in foreclosures, bankruptcies, and credit card delinquencies. Mr. Birnbaum stated that Iowa has 61,000 unemployed Iowans. For Iowans that fail to make payments on mandatory home insurance, they will be placed in expensive force-placed policies.

In response to Mr. Birnbaum's comments, Alex Hageli, Property Casualty Insurers Association of America (PCI) Manager of Personal Lines made comments. Mr. Hageli explained that studies have shown that insurance scoring is predictive of loss. Mr. Hageli stated that insurance rates would increase with a ban on insurance scoring. It was also stated by Mr. Hageli that most benefit from insurance scoring.

III. Consumer testimony and comments on the use of credit scores in insurance (seven consumers were present, but only 3 choose to share testimony):

Lelah Swallow:

Ms. Swallow expressed her concerns that she and her husband were going through difficult times and that it was not fair for her family to be penalized by being made to pay more for insurance because of credit. Ms. Swallow explained that the market is in horrible shape and there are no jobs available right now. Ms. Swallow also said it was not fair for consumers to have to pay higher car insurance when Iowa requires car insurance. Car insurance should be affordable. A concern was also shared for victims of domestic violence who leave a violent situation and as a result it sometimes leads to ruined credit. Ms. Swallow did not feel victims should be penalized for their credit and be forced to pay more for insurance. Ms. Swallow is concerned that people will go without insurance if it becomes too expensive. It was Ms. Swallow's opinion that car insurance should be based on driving records and claims history.

Robert Pinniger:

Mr. Pinniger was a small business owner who was forced to claim bankruptcy because the business failed. Mr. and Mrs. Pinniger always paid their personal bills and debts on time even while the Pinniger's small business was in bankruptcy. This should be seen as a sign of their financial responsibility. The Pinniger's were notified that their insurance would be increasing by hundreds of dollars due to their insurance score decreasing. The Pinnigers felt they had been loyal claim-free customers and it was unfair to punish them for being unfortunate enough to lose their business, when they have paid their insurance in a timely manner.

Lance Horbach:

Mr. Horbach commented that there were some problems with insurance scoring and that it was not perfect. Mr. Horbach explained that just because there were problems with insurance scoring it did not mean it should be completely banned. He is concerned with the possible affect on premiums if a ban was instituted.

One problem area that Mr. Horbach had seen comes from the disparity in the range of prices a consumer may face due to their insurance score. Mr. Horbach also mentioned in response to Ms. Sallow that he was a legislator and that the reason a liability level of $10,000 was set was to protect consumers who requested assistance for accidents that resulted in major injuries and the party at fault had no insurance. Mr. Horbach explained that Iowa has a really low motor vehicle liability requirement.

IV. Closing remarks by Consumer Advocate:

An industry representative was requested to answer questions about the recently passed National Conference of Insurance Legislators (NCOIL) model act amendment. Representing the industry was Mr. Hageli. Ms. Robinson asked if the industry was participatory in forming that model legislation. Mr. Hageli commented that the industry did participate. Ms. Robinson asked if the NCOIL model allowed insurers to do something new or were insurers already able to provide extraordinary life circumstances exceptions for their consumers. Mr. Hageli agreed that insurers could at their discretion provide extraordinary life circumstances exceptions.

Ms. Robinson thanked the consumers for attending and sharing their comments and personal stories that evening. Mr. Birnbaum was thanked for traveling to Iowa to share his testimony. Interested parties were told to submit any written testimony before October 1, 2009 for review.

Presentation of Birny Birnbaum on Insurance Credit Scoring

Public Hearing in Des Moines, Iowa

September 16, 2009

My name is Birny Birnbaum. I am the Executive Director of the Center for Economic Justice, a non-profit consumer advocacy organization. I have worked on insurance credit scoring issues since 1992 as both an insurance regulator and consumer advocate. Attached is a copy of my resume.

Consumers are facing dire economic conditions due the meltdown in financial markets and economic recession. These factors are causing a crisis for insurance consumers because of insurers' use of consumer credit information for pricing auto and homeowners insurance. While insurers argue that there are few consumer complaints, the number of complaints simply does not reflect the lack of understanding by consumers and the severe problems with credit scoring.

In summary, insurance scoring:

1. Is Inherently Unfair
    a. Penalizes Victims of Medical, Economic Catastrophes
    b. Arbitrary and Illogical Results, Unrelated to how well a consumer "manages" her finances.

2. Is Unfairly Discriminatory in a Regulatory Sense
    a. Discriminates on the basis of race -- credit reports reflect and perpetuate historical inequities.
    b. violates actuarial principles;

3. Undermines the Core Public Policy Goals of Insurance
    a. undermines the goal of universal coverage by worsening the availability and affordability of insurance for those consumers with the least means to purchase insurance; and
    b. undermines the loss reduction role of insurance by encouraging consumers to spend time manipulating credit scores instead of reducing exposure to risk.

4. Is Not Needed – states which ban insurance, such as California and Massachusets have thriving markets. Insurers entered the Massachusetts auto market after partial deregulation, even though credit scoring is banned.

5. Objective, independent Data show confirm the problems with credit scoring, in contrast to self-serving and unverified statements of credit bureaus and insurers
6. Problems are not limited to auto and homeowners insurance – now see medical credit scores.

7. The NCOIL model provides no substantive consumer protections – no meaningful disclosure, no meaningful prohibitions against unreasonable behavior and no meaningful help for consumers suffering a catastrophic event.

Many agent groups opposed insurers' use of credit information including State Farm, Farmers and Allstate agents' groups. They are not here because of fear of retaliation by the insurers they work for.

The Crisis Caused by Reckless Lending and Dire Economic Conditions

Insurance scoring is inherently unfair because it penalized victims of economic and medical catastrophes. The most recent Harvard study of bankruptcies found that 62% of bankruptcies were caused by medical costs and the majority of these bankruptcies were in families with health insurance. It is simply unfair to charge higher auto or homeowners insurance premiums to consumers who suffer financial distress because of medical costs or job loss. The number of bankruptcies in July 2009 was the highest since Congress changed the bankruptcy laws in 2005 and made it more difficult to file bankruptcy.

The growth in the number of foreclosures is a glaring indicator of financial crisis for millions of Americans. The following data come from RealtyTrac

Number of Foreclosures Countrywide

2005	885,462	
2006	1,259,098	
2007	2,203,295	
2008	3,157,806	
2009	2,246,984	8 months
2009	3,400,000	current full year estimate

Foreclosures were initially concentrated in the subprime market, moved into alt-A and now seen massive increases in prime loan foreclosures.

Bankruptcies are up – even after the new law to reduce bankruptcies

Credit card and mortgage delinquencies are at all time highs – having increased dramatically over the past few years.

Mortgage delinquencies and foreclosures are projected to continue at high levels for several years due to resetting of interest-only loans and high unemployment.

The Census Bureau just released *Income, Poverty and Health Insurance Coverage in the US in 2008.*

Real Median Household Income Decline from 2007 to 2008 by 3.6%, falling to levels not seen since 1997. That was before the severe economic downturn in 2009.

Poverty Rate up from 2007 to 2008, 12.5% to 13.2% -- the highest since 1997 – 40 million people in poverty. The poverty rate for Blacks was 24.7% and 23.2% for Hispanics.

The number of people without insurance in 2008 was 46.3 million or 15.4% of the population. The percentage of people covered by private health insurance declined. The percentage of uninsured Blacks and Hispanics were 19.1 and 32.1, respectively

The Bureau of Labor Statistics reports that unemployment has increased countrywide and in Iowa

Iowa
Jan 2007, 60,809 unemployed, 3.7% rate
July 2009, 109,134 unemployed, 6.5% rate

The number of consumers unable to maintain auto or homeowners insurance policy payments has increased dramatically as measured by increased in the amount of creditor-placed insurance written. Consumers who take out an auto or home loan are required to maintain insurance on the vehicle or property and agree that, if they fail to do so, the lender may force-place the insurance. The table below shows massive increases in creditor-placed homeowners insurance countrywide and in Iowa.

2004	CP Home	CW

			$1,485,338,992
2005	CP Home	CW	$1,831,583,174
2006	CP Home	CW	$2,153,104,678
2007	CP Home	CW	$3,057,956,945
2008	CP Home	CW	$3,986,950,803

2004	CP Home	IA	$5,239,337
2005	CP Home	IA	$5,873,503
2006	CP Home	IA	$6,341,936
2007	CP Home	IA	$7,277,143
2008	CP Home	IA	$9,126,999

Adding to consumer woes are lender decisions to cut credit limits, tighten underwriting, raise interest rates and fees.

Credit scoring penalizes consumers for the business decisions of lenders – even when those business decisions were terrible and included poor business practices, predatory lending, fraud and excessive risk taking. Virtually all of the companies responsible for the hundreds of billions in subprime loans issued from 2005 to 2007 are out business.

Insurance Scoring is Actuarially Unsound

Insurance scoring violates actuarial standards of practice because insurance scores are not objective, are arbitrary and subject to manipulation. See my testimony on actuarial consideration at the April 30, 2009 NAIC hearing for more detail, but the following provides a list of problems.

<u>Not Objective</u>

1. Differences across credit bureaus

2. Differences within a credit bureau due to lender choices
3. Changes in definitions of credit report items – bankruptcy law change
4. Public policy initiatives changing credit scores – moratorium on foreclosures
5. Lack of information – 25% of reports contain insufficient information for scoring, clearly that 25% of population have a variety of risk characteristics
6. Timing of report – balance to limits varies by time of the month
7. Decisions of lenders – not reporting limits, changing limits

Manipulation

1. Invitations/Solicitations for Manipulation
2. Piggy-Back on another consumer
3. Shift balances from one car to multiple cards

Penalize Consumer for Rational Behavior

1. Shop around for best rates
2. Cancel a card when lender acts unfairly
3. Get a card to get 10% first visit discount

Life Exceptions: In other hearings – and in the revised NCOIL model – insurers will ignore the credit score under certain events – divorce, natural catastrophe, job loss, major medical problem. Why do they do this – why would an insurer ignore the credit score – because public policy makers and insurers recognize that scores do not reflect risk under certain circumstances. This means that the use of credit scores is unfairly discriminatory – those who know to ask and are granted a life exception are treated differently than those who don't know to ask. More important, it is an arbitrary practice to ignore the credit score – if the score is associated with risk, then it shouldn't matter how what caused the score. If a score can be ignored for some reasons, then the score is arbitrary – actuarially unsound and unfairly discriminatory.

A Discussion of Data Sources

Suppose I came in and said we had done a detailed survey of 1 million consumers and found credit scoring discriminates against minorities and low income consumers and was not related to risk of loss. You would reasonably ask to see the methodology and the data to verify the claims. And if we said, sorry, the data are confidential, you have to take our word for it – you would not do that. Even though we have no financial stake in this – even though we work on behalf of consumers.

Yet that is exactly what regulators and state legislators have done with insurers – assume that insurers and credit bureaus are providing accurate information even though the insurers and bureaus have a huge financial stake in the outcome of the policy debate.

The credit bureaus and modelers get up and tell you everything is great – yet these folks have a financial interest in the outcome of the debate. It's like going to Enron and asking Enron if its electricity trading in CA benefited consumers.

The credit bureaus come in and say scores are stable – no way to verify that.
The insurers come in and say that scores are stable – no way to verify that.

Except we have common sense – we can see the credit scoring models – public in TX and some other states – and we can see the factors in those models and we can see public data on what is happening with economic conditions and it is clear that insurance scores are being creamed for millions of consumers – the very consumers who are victims of abusive lending and the recession.

Insurers have a track record of misleading regulators and policy makers. In the late 90's, there was a debate on whether credit scoring discriminated on the basis of income. The American Insurance Association produced a report claiming that one of its member companies had done a thorough study and found no correlation. It was not true – when the Missouri Department of Insurance did its comprehensive study, it found a powerful correlation to income – as was evident from just looking at the models at the time. Delinquencies and debt burden are correlated to income levels, clearly indicating that credit scores were correlated to income. Yet insurers denied it – misleading policymakers – just as they today deny that insurance scores have not been hurt by the worst economic conditions and credit markets in 80 years.

Insurance Scoring Is Not Needed – States That Ban Insurance Scoring Not Only Show No Market Problems But Outperform Other States.

California and Massachusetts have not permitted insurance scoring for auto insurance. Hawaii prohibits the use of credit information for all personal lines of insurance. Maryland has banned insurance scoring for homeowners insurance. Yet all these markets thrive. In fact, the uninsured motorist rates in California and Massachusetts dropped significantly from 2004 to 2007, according to the Insurance Research Council even as the countrywide uninsured motorist rate increased.

Insurers Claims about Benefits of Insurance Scoring Are Not Supported By the Facts

The insurers' arguments for insurance scoring boil down to one claim: credit scores are predictive of losses. All the alleged benefits flow from this one assertion:

1. More accurate rating – prevents one group of consumers from subsidizing another

2. Promotes competition – insurers who can price more accurately will write more business and take a lower profit because of less uncertainty

This is wrong as a matter of policy and is refuted by the facts.

The logical extension of the insurer argument – more accurate rating is good – is a pay as you go system and the end of insurance.

The purpose of insurance is not to predict risk – it is to pool risk so insurers can provide an essential financial security tool to consumers.

Certainly, it is necessary for a risk classification to be substantially related to expected losses, but such a statistical relationship is not sufficient. Suppose we heard these same arguments for health insurance – pre-existing conditions and family history/genetic makeup are highly predictive of future health insurance claims and, therefore, insurers should be able to utilize pre-existing conditions and genetic tests in rating health insurance. The answer to that is a resounding no – as a society, we realize that the purpose of insurance is to pool risks, not to create a pay as you go system.

Or suppose we heard these same arguments claiming that race and religion were essential risk classification tools for insurers because they were predictive of risk. Again, no way. These classifications are prohibited because they undermine the public policy goals of insurance – and they are not needed to protect the insurance system.

What about the claim that credit scoring creates more competition, more availability and more affordability?

There is no evidence to support these claims. Profitability has increased as loss ratios have declined – a result inconsistent with "more competition." Uninsured motorist rates have increased as has the amount of creditor-placed homeowners insurance. According to the Insurance Research Council, the uninsured motorist rate in Iowa over the years:

95-97: 10%
2004: 12%
2005-07: 12%

There is no evidence of greater availability or affordability of insurance due to insurance scoring. Insurers attribute the decline in auto residual markets to insurance scoring, but again the data do not support the conclusion – data from AIPSO, the manager of auto assigned risk plans in most states, shows that California experienced a higher percentage reduction in assigned risk premiums from 2003 to 2007 than the countrywide average – despite the ban on credit scoring for auto insurance in California.

Banning credit scores will not raise premiums

On average, insurance scoring redistributes premium with no change in the average premium because there is no short-term impact on claims or expenses which drive overall premium requirements.

Iowa has lower average insurance premiums than the national average because Iowa has much lower population density than most states and because consumers buy less insurance in Iowa than in other state. Insurance premiums are driven by claim costs and claim costs are driven by number of accidents – population density – and amount of claims – amount of coverage. States like NJ and MA and DC have high premiums because they have high population density and higher amounts of insurance.

Insurers defend credit scoring by claiming that a ban on scoring will result in higher rates for the lower risk drivers. And insurers also claim that most consumers have good scores.

Let's take them one a time –

Most consumers benefit:

1. No objective data to prove that – my review of rate filings indicate 50/50 in terms of immediate rate change. Over time, more consumers will suffer because of the absence of loss mitigation incentives and higher uninsured motorist.
2. So what? Would we justify health insurance rating based on pre-existing conditions because most consumers would benefit? Or justify use of race because most consumers would benefit? Profoundly un-American.
3. Over what time period? Consumers' insurance scores change, so a consumer who gets a rate increase this year because credit scoring is banned might avoid a rate increase next year if credit scoring was continued because of cancer in the family or job loss.

Higher Rates for Many If Banned

1. Not believable – push away best customers. self-serving statement with no verification – points out need for department to be collecting data.
2. Analyses likely based on simply removing credit from existing rating plans – not the way it works. Insurers use GLM – rerunning the models without credit would change other rating factors.
3. Tillinghast – eliminate credit, still able to accurately price
4. Cynical ploy by insurers to intimidate regulators and legislators – telling regulators and legislators that rates will increase for most consumers

Insurers can't explain why credit scores are correlated to claims, so they blame the victim – saying scores reflect personal responsibility. But at the same time, insurers argue that insurance scores have been stable during the current economic crisis.

According to FICO:

It's common sense that credit habits relate to insurance risk—

> *Overall behavior is consistent—In general, people with good credit habits demonstrate careful behavior overall. This crosses over into their driving habits, care of their automobiles, and care taken in the maintenance and safety of their homes.*

Scores remain an effective tool during current economic conditions—

> *Scores have shown to be very stable—In recent countrywide studies of FICO® Credit-Based Insurance Scores, the average scores have remained virtually the same for the general population. This is especially noteworthy during an economic downturn when the number of people who are delinquent in repaying creditors has clearly grown. We suspect the overall stability of these scores may be caused by a greater number of consumers making certain to pay all bills on time, paying down outstanding balances, and perhaps not seeking more credit obligations. In a word, more and more consumers appear to be realizing the value of prudent financial and credit management practices.*
>
> *Scores may decline for those directly impacted—As a small but growing number of consumers have experienced recent financial hardships, such as mortgage foreclosures, it is impossible to generalize about the impact of such an event on an individual's credit-based insurance score. In each case the scoring formula considers the interrelationship of all credit information in each consumer's credit report, including any foreclosure information reported to the credit reporting agency.*

First, this is offensive. To claim that consumers whose credit scores are hurt because of job loss, divorce, medical catastrophe, natural catastrophe, fraudulent and reckless lending decisions of lenders, changing business decisions of lenders and many other business practices unrelated to how a consumer manages her finances is not responsible is simply blaming the victim for being unfortunate.

And even a cursory review of what goes into a credit report indicates that credit scores are not a measure of overall financial responsibility, let alone personal responsibility – no rent, no utility, no insurance payments, no high-priced lenders, no limits reported by some lenders, no info in some bureau reports. No info on savings, insurance, retirement or other aspects of financial planning. No info on vehicle maintenance.

It is outrageous to claim that an insurer can evaluate a consumer's personal responsibility by looking at the number of inquiries in a credit report or whether the consumer has a department store credit card.

Second, there is a profound contradiction. If scores are a measure of financial responsibility" as claimed by insurers, then scores should be declining as the number of consumers who are delinquent on loan, who default on loans, who have lost homes to foreclosure, who file for bankruptcy, who have higher debt to credit limit ratios because of lender reductions in credit limits. Indeed, the credit bureaus admit that credit scores have declined, but claim that insurance scores are stable

Third, average scores don't tell the story – for every consumer whose score has been trashed by a foreclosure, there may another consumer whose score has improved (from an already good level) because of paying down some debt.

Fourth, the claim of stable scores does not pass the smell test: Look at the models and see that the factors in those models have deteriorated – defaults, delinquencies, public records. Bureaus claim that is is offset by consumers borrowing less and improving credit ratios – debt to credit limits. In contrast to these unverified claims:

Fed Data (consumer lending way down 090908) – revolving debt 8.9 in first quarter from pervious year, 8.2% in second quarter from previous year. Consumer credit 3.6% decline first quarter, 5.2% second quarter.

Experian and Oliver Wyman also state in their Q2 2009 Market Intelligence Reports that lenders continue to manage their risk exposure by aggressively reducing credit lines on revolving loans such as bankcards. Over the last 12 months, bankcard credit lines have declined from $3.8 trillion to $3.1 trillion, a 17% decline.

With credit limits declining more than consumer debt, debt to limits ratios must increase.

Insurers defend credit scoring by saying it is objective, factual and accurate – and that credit scores are color blind.

Objective, factual – as if all information was accurate and all relevant information was included. Not true. The fact that scores are produced by pushing data through a model does not mean the score is objective and non-biased.

The models include only credit information – no claims information is included – yet the modelers claim that the models are highly correlated with claims. If this is true, then the models could also be correlated with race or income, even if those characteristics are not used.

What models predict: When insurers talk to investment analysts who evaluate their stock, the insurers tell a different story than the one told to state legislators and regulators. Consider the comments of Ed Liddy, then-CEO of Allstate to investment analysts in 2005:

> Tiered pricing helps us attract higher lifetime value customers who buy more products and stay with us for a longer period of time. That's Nirvana for an insurance company. That drives growth on both the top and bottom line.
>
> This year, we've expanded from 7 basic price levels to 384 potential price levels in our auto business.
>
> Tiered pricing has several very good, very positive effects on our business. It enables us to attract really high quality customers to our book of business.
>
> Make no mistake about it, the economics of insurance are driven largely by retention levels. It is a huge advantage. And our retentions are as high as they have ever been.
>
> The key, of course, is if 23% or 20% of the American public shops, some will shop every six months in order to save a buck on a six-month auto policy. That's not exactly the kind of customer that we want. So, the key is to use our drawing mechanisms and our tiered pricing to find out of that 20% or 23%, to find those that are unhappy with their current carrier, are likely to stay with us longer, likely to buy multiple products and that's where tiered pricing and a good advertising campaign comes in.
>
> It (tiered pricing) has raised the profitability of the industry.[109]

As made clear by Ed Liddy's comments, insurance scoring is used to predict consumer profitability, which is not the same as predicting risk of loss.

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[109] Partial Transcript of Presentation to Edward M. Liddy, Chairman and CEO, The Allstate Corporation

Twenty-First Annual Strategic Decisions Conference, Sanford C. Bernstein & Co., June 2, 2005.

E. Appendix 3C: Aggregated Consumer Complaints and Testimony

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T 1	Consumer is 71 years old and lives on a fixed income. He does not believe in living on credit and has recently paid off his mortgage. Afterwards he received a letter from his insurance company that told him his insurance premium was going up due to having insufficient length of credit, too high credit limits or no credit, and no revolving loans. Consumer believes that not using credit does not make him a bad risk, and that the practice is not fair to those on a fixed income. He believes that this practice should be illegal.	Y		X (fixed income / paid off debt)		
T 2	The consumer attempted to lower monthly bills by refinancing her home loan. She shopped around for the new mortgage resulting in multiple inquiries on her credit report. When questioning why her insurance premiums increased to over $250, the consumer was advised that the increase was due to having too many inquiries on her credit report. She is concerned that insurers are taking advantage of consumers who are refinancing their homes. The consumer feels that the insurer was being unfair, since she was a loyal customer and paid her bill on time. The consumer feels insurers should not have access to credit reports at all, that her credit report should have nothing to do with her insurance premium.	Y	X	X (refinancing)		

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T 3	This gentleman shared concerns generally as an individual who works in the insurance industry. He was concerned that credit reports results are used to segregate consumers on an economic level. He saw prices skyrocket for consumers with lower incomes to the point that those consumers could no longer afford to pay the insurance on their homes. The gentleman saw more issues with homeowners insurance than with auto insurance, as auto coverage levels can be manipulated to reduce costs. The gentleman was concerned that if insurers cannot use credit reports to determine insurance rates, they will stop writing policies in low income neighborhoods. Concern was also expressed for consumers who experienced identity theft. The gentleman feels that insurance companies have plenty of opportunities to use other factors besides credit rating to set rates.	N		X (low income / identify theft)		
T 4	This consumer has low credit scores because of identity theft. The consumer expressed that it takes time to fix credit, but there was no exception made for such a situation. Consumer feels this is an injustice.	Y		X (identity theft)		

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T 5	This consumer's insurance score became lower (although her credit score remained high) and caused an increase in her insurance premiums. The consumer did not understand why this should be, as she and her husband had no accidents or traffic tickets that might have caused the change. Consumer wanted an explanation. The consumer believes this practice is "shocking," "dishonest," and "insulting".	Y	X		X	
T 6	The consumer's credit report showed nothing adverse, but his insurance premiums increased due to insurance scoring. His insurer could not tell him how his score was calculated and informed him that the information was destroyed. The consumer was informed that he would have to pay to see a copy of his credit report since he had reviewed his free report for the year, and was also told that any information he received would also not replicate what the insurance company reviewed, as his credit report changed daily. The consumer was concerned about the accuracy of credit reports, due to the daily changing status of reports. He uses his charge cards, then pays them in full every month, and was concerned that if the insurance company reviewed his credit report before he made the monthly payoff, they would receive an inaccurate reflection of his financial picture.	Y			X	

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T 7	This consumer's insurance premiums increased due to credit scoring. The consumer believes that credit scores should have nothing to do with insurance as long as his bills are paid on time.	Y	X			
T 8	The consumers lost a small business because they could not afford to financially continue; they declared bankruptcy. The couple always paid their insurance bill on time, but the insurance company increased their auto insurance premium by over $150.00. They were told it was due to the bankruptcy and that they should expect an increase in their homeowner's insurance premiums also. The consumers feel they have been loyal, good, paying customers for over 16 years with a low claims history. They feel this information was dismissed and that instead they were penalized by the use of their credit report.	Y		X (lost small business)		
T 9	The consumer did not believe that he should have to provide his social security number in order to obtain an insurance quote.	N				privacy Issue

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T 10	The consumers are generally concerned that the use of credit reports to set premiums penalizes consumers for years when they have an extraordinary life change or circumstance that impacts their score, such as a job layoff or medical bill issues. These issues stay on the credit report long after the consumers' lives are stabilized. The consumers also believe that if poor people are penalized with higher rates, they will be less inclined to carry proper insurance, which penalizes the rest of consumers who must pay higher rates as a result (uninsured/underinsured motorists).	N		X (concerned about longevity of life events on credit)		could cause increase in under-insured drivers
T 11	The consumers felt fortunate that they were able to pay off their home mortgage. However, doing so caused a negative impact on their insurance score and an increase in their insurance premiums. The consumers feel punished for not carrying debt, and do not feel this makes them a high risk. The consumers also believe actuarial numbers showing predictability are manipulated to say what an insurance company wants them to say. Insurance scoring models were also criticized as they are secret. The consumers are very frustrated with the subject and remain unconvinced that credit has a link to insurance claims or severity.	Y	X	X	X	

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T 12	The consumer takes issue with the fact that each insurance company handles the use of credit scores differently. He also believes that situations in life that affect finances should not be the cause for an individual's rates to increase- he is concerned that it takes advantage of a situation where people are already struggling. The consumer believes that a person's credit rating has nothing to do with insurance and that it overshadows other factors that can be used, such as driving records.	N	X	X		insurance companies use insurance scoring differently
T 13	The consumer is concerned for Iowa's older population who pay for most things with cash. He is concerned that these consumers will be negatively affected because they don't have significant credit histories.	N		X		

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T 14	The gentleman works in insurance and is concerned for Iowans with lower incomes because these consumers have a higher likelihood of having to make a payment late or have trouble making their insurance payments. The consumer does not believe this is fair, because Iowa has minimum liability coverage and credit scores can make this less affordable for low income consumers. The consumer believes that the current economic situation is exacerbating the problem. Concern was also expressed over the weight (importance) given to the credit score over other factors. The consumer stated that he has seen as high as a 70% difference in premium. He is concerned that retired and fixed-income individuals (who are less likely to use credit, and therefore generate no credit score) are given a neutral score, because they will miss out on the opportunity to receive a financial stability discount. The consumer has also found that there is no clear answer given to individuals on what criteria is used to calculate an insurance score. He believes consumers have a right to know this information and currently it is not provided.	N		X	X	concerned that companies use credit in an inconsistent manner
T 15	The consumer has been the victim of identity theft. She expressed that correcting and fixing the problem takes time. She believes she is a victim of a rising crime in this country and that insurers should not be allowed access to this information.	Y		X		

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T 16	This consumer has gone through tough times in life leaving her with a low credit score. She believes that times are difficult enough without increasing insurance rates because of an individual's credit. Consumers with low scores are individuals that are struggling. She disagrees that a consumer's insurance premiums should be increased because they decide to put food on the table instead of paying a charge card or loan payment on time.	N		X (low income)		
T 17	This consumer believes insurance scoring is grossly unfair. Her daughter has worked hard for two years to get out of debt, but has had increased insurance premiums due to credit history. The consumer believes that credit ratings are not always accurate representations of a person. She does not understand the basis for the use of credit scoring in determining insurance premiums and believes it is unfair.	Y	X			
T 18	The consumer is 80 years old and does not have any credit cards or credit. He believes that it is not fair that he pays more for insurance for not having credit.	N		X (No credit)		
T 19	The consumer believes that credit scores have nothing to do with insurance and that it is an unfair practice. She believes her family's credit history is not the business of the insurance company.	Y	X			privacy issue

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T 20	The consumer does not believe in credit and believes he does not need credit. He pays for things with cash instead, and feels that insurers who use insurance scoring are punishing prudent behavior. He believes that people need to be protected from these "predatory practices" especially when insurance coverage is required.	N		X (no credit)		
T 21	This consumer is 67 years old. Her home insurance increased by $277 because she does not have good credit. She does not believe that a low score means she will be more likely to file a claim. The consumer stressed that she has never filed a homeowner's claim even though she does not have good credit.	Y		X (no claims)		
T 22	The consumer has been affected by difficult life circumstances (serious illness/divorce) and feels she has no recourse for her insurance company's insurance scoring actions. The consumer feels that she is being penalized for making an average wage and struggling to meet her personal expenses. Consumer notes that she carries insurance as required by her lender and meets state law requirements. She feels credit has nothing to do with insurance or her responsibility levels.	Y	X	X (life events, average income)		

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T 23	The consumer is concerned for his elderly parents who are in their 80's and live on a fixed income. His parents have had increased premiums due to a negative credit history from many years ago. Consumer's parents do not want to go through the struggle to correct the problem as they believe it is too much to handle at their age.	Y		X (report error)		
T 24	The consumer lost his small business and went through a divorce which caused him to have to declare bankruptcy. These issues ruined his credit, but the consumer always paid his insurance premiums and home mortgage payments. Since the time of his bankruptcy and divorce, the consumer has received notices from his insurance company that his insurance premiums have been negatively affected. When the consumer requested a copy of how his score was calculated, he was denied. When the consumer requested an explanation for the higher rates, he was forwarded to a third party (the credit model company). The credit model company likewise failed to tell him how his scores were calculated. The consumer also expressed that he did not believe credit had anything to do with insurance.	Y	X	X(life events)	X	

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T 25	The consumer works in the insurance industry and has had the same insurer for 40 years. He has received adverse action letters for years even though he has not had any claims since the 1990's. Consumer noted that he was very financially responsible, by having paid for his home in cash in 1977, having a paid-off car, and only one credit card. Consumer disagrees that he would be more likely to file an insurance claim. The consumer believes credit scoring is a method for insurers to continue to bring in more premiums without raising rates. The consumer believes that the practice of using credit reports to determine premiums is dishonest and an insult.	Y	X			
T 26	The consumer refinanced his home which led to increased insurance premiums. He was trying to lower monthly mortgage payments, but received increased insurance premiums in trade. Consumer disagrees with using credit scoring in insurance because he believes it has nothing to do with how he takes care of his home or drives his car.	Y	X	X (refinancing)		
T 27	Consumer believes that common sense needs to be used and that insurance scores have nothing to do with the number of claims a homeowner's policy has or how a car is driven.	N	X			
T 28	The consumer believes that using credit scoring to determine insurance premiums is an invasion of privacy. Consumer feels this is a personal right lost.	N				privacy issues

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T 29	The consumer believes insurance premium rates shouldn't be determined by credit reports. He believes that insurers should not care about credit as long as premium payments are made on time.	N				believes practice is a scam
T 30	The consumer is happy with her insurance rates and the use of credit scoring. She feels irresponsible people should be penalized.	N				approves of practice
T 31	This consumer pays his bills on time and has a good credit rating. He does not believe in changing the benefits of insurance scoring for those who have earned them. The consumer believes that insurance scores are mathematically related even if it is a matter of character or affluence.	N				approves of practice
T 32	A consumer and his wife expressed their unpleasant experience with insurance scoring. The couple did not believe that insurance scoring was a predictor of a future claim because they had had no claims and their insurance premiums had recently been increased. They had paid off and owned their vehicles and paid all their bills on time. The couple also stated they had good credit scores, and they did not believe that it was fair to be penalized for owning their property. Consumers also stated that they had no claims and that is what they should have their insurance premiums based on, not credit which they did not believe was an accurate predictor.	Y	X	X (no claims/ and owned property)		

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T 33	The consumer had lost her job and was being personally affected by insurance scoring. She stated that even though she paid her insurance on time and has filed no claims for decades, she had her insurance premiums increased. The consumer found out it was because her credit was not where it was before she lost her job. The consumer felt that she was being penalized for being laid off even though she had been a faithful customer who always paid her insurance bill on time. She was concerned that she was going to be forced to make the difficult decision of paying for insurance or needs.	Y		X (no claims / life events)		
T34	This consumer found out that he was not eligible for the best insurance rates because he lives his life without credit. He paid cash for everything and owns all his own property, as he was raised to do (consumer was a senior). Nevertheless, he tried to get the best insurance rate by getting a credit card. The consumer was turned down because he did not have any credit history. Then the consumer found out that being turned down for the credit card made his absent credit history worse. The consumer expressed that there was no way for him to fix this, because he had to have credit to get credit and without credit he did not qualify for the best insurance rates.	Y		X (no credit)		

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
T35	Consumer shared that she and her husband have been going through a tough time as she is disabled and her husband cannot find work. The consumer expressed concerns of fairness that her insurance should increase when payments are made on time and claims are not filed just because her family is in a difficult financial place. She also shared concerns that women who are victims of domestic violence should not have to stay in a bad marriage in order to protect their credit.			X (life event)		Concerned about victims of domestic violence staying in bad relationships to protect finances
T36	This gentleman works in insurance and believes that insurance scoring has some problems, but it should not be banned. He believes that one of the biggest problems comes from the disparity in range of premiums assigned to different insurance scores.					Believes there are some problems, but insurance scoring should not be banned
1286	Gentleman working in insurance shared concern that he thinks it is unethical for insurance companies to use credit ratings to set premiums, because 25% of all credit reports are inaccurate.	N		X (inaccurate reports)		
3157	The consumer's auto insurance premium increased due to the use of credit scoring.	Y				generally disagrees with practice
11154	The consumer is over 60, and is paying higher car insurance premiums because he has no credit history. He pays his bills by cash and check and does not want a charge card. He feels this is age discrimination, because many seniors prefer not to use credit.	Y		X (no credit)		

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
21255	The consumer did not want to provide his social security number, which the insurance company required for policy renewal. He was told that they had to have it to run a credit report. Since he had carried the policy for over twenty years and had always paid his premiums when due, he did not feel it was any of the insurance company's business what his credit report stated. Consumer feels that the credit report should have no correlation to insurance premiums.	Y	X			privacy issues
22848	The consumer's premiums increased substantially which she eventually discovered was due to an error in her credit report. This took considerable time and effort to correct, and she was forced to pay higher premiums in the meantime.	Y		X (report error)		
23083	Car insurance premium increased by $150 annually because the consumer had recently applied for a single credit card. The consumer feels there is no justification for this practice.	Y	X	X (applied for one credit card)		
26420	The consumer's insurance company would not renew her car insurance because of a negative credit report and one claim. Consumer recently was able to refinance her mortgage, so she doesn't understand why her credit report was acceptable for that, and not for the insurance company. It is possible that the refinancing process is what caused her credit report score to drop below the insurance company's accepted levels.	Y		X	X	policy nonrenewal with one claim added plus credit report

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
30256	The consumer's homeowner's insurance premium went up by more than $300 annually based on her credit report. Insured has had only one claim, has been with the company for many years, and has always paid premiums when due. The consumer believes that the use of credit reports to determine premium is an unfair practice.	Y		X		
34651	The consumer had extraordinary circumstances (in taking a new job, she and her spouse were not insurable until after a two-month waiting period, and in that time, her husband had two heart attacks requiring hospitalization). They filed for bankruptcy to discharge the hospital debt and one charge card, trying to be responsible and retaining their home and car payments and all other charge accounts. Their credit report caused their insurance premiums to increase when they could least afford it. The consumer doesn't believe that just because they had these financial problems that they are any more likely to file an insurance claim than anyone else.	Y	X	X (life events)		
34918	The consumer had paid all of his charge cards and installment loans off, and was surprised to find that this caused his auto insurance premium to increase. As a senior citizen, he wonders if the company is engaging in age discrimination. He also felt that insurance companies should not be able to access his credit report without his permission.	Y	X	X (no credit)	X	

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
36273	The consumer tried to simplify his finances by reducing the number of charge cards he had. His aim was to write fewer checks each month. Doing this actually made his credit score decline significantly, and his homeowners insurance premium was increased. He feels that there is not always a correlation between a low credit score and an increase in insurance claims, and that it is impossible for consumers to figure out how to increase their credit score to get better insurance rates.	Y	X		X	
59871	The consumer's homeowner's premium increased by $200 annually after the insurance company began using credit reports to tier premiums. He feels this is unfair, and that his credit report has no connection to the number of claims he might make on his insurance policy.	Y	X	X		
61802	Consumer complained that her homeowner's insurance increased over $600 annually due to her insurance score.	Y		X (insurance score sole reason for premium increase)		
62029	Consumer's homeowner's insurance was increased due to insurance score.	Y		X (insurance score sole reason for premium increase)		

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
62343	The consumer's auto insurance premium increased after his insurance company began using credit reports to determine premiums. The consumer, who works in the insurance industry, feels that he is being discriminated against because he owes too much money on charge cards, due to a failed business. He believes that credit scoring has no bearing on the number of claims filed.	Y	X	X (life events, practice is discriminatory)		
63602	Consumer is a senior citizen who complained that he was not eligible for the lowest rate with his insurance company because he had no credit.	N		X (no credit)		
64887	Consumer read her disclosures and was concerned that her personal information was being accessed and sold. Consumer also questioned what a credit score had to do with homeowner's insurance.	N	X			
65117	This consumer was subject to mass company layoff from his job. He proceeded to cut personal expenses in order to live within his means and avoid adding debt. Three months after being laid off, the consumer was told that his auto insurance would be increasing due to a lower credit score. He questioned what credit had to do with his insurance. The consumer also emphasized that even thought he had been laid off, he had never failed to meet any of his financial obligations on time. He felt he was being discriminated against, due to being laid off.	Y	X	x (life event)		

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
65598	This consumer has been forced to declare bankruptcy due to a loss in finances that were out of her control. She believes insurance companies should look at a consumer's ability to pay instead of an insurance score.	Y		X (life event)		X (generally disagrees with practice)
65686	This consumer's insurance premium increased due to having too many requests/inquiries on his credit report. The consumer obtained his credit report and he found no inquiries, other than those of the insurance company. He then requested that his insurance company elaborate on the inquiry information his credit score was based on, and the company would not provide this information. The consumer requested a supervisor to discuss the matter further, and was told someone would contact him. The consumer never received a return call.	Y			X	consumer questions if prohibited factors were considered

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
65956	The consumer received adverse action notices two years in a row. The primary credit characteristics that adversely affected the consumer's credit were insufficient length of credit and too many recent credit checks. The consumer was confused why he would be considered to have insufficent credit when his credit history started in the 1960's, and he had a credit score of 892. The consumer also stated that he tried to find out how many credit checks were considered adverse. Consumer explained that when he contacted the insurance company he was referred to the credit reporting agency. The credit reporting agency in return referred the consumer to the insurance compnay. Neither company explained to the consumer how many credit checks it takes to adversely affect his insurance. The consumer was seeking assistance in finding someone who could advise him on what credit changes were needed to improve his insurance premiums. Consumer did not want to receive any more adverse action notices.	Y		X (no credit)	X	
66024	This consumer was upset when her insurance premium increased due to a drop in her insurance score. The consumer was informed that one of the reasons for her adverse action was the number of inquiries on her credit report. Consumer noted that four of the six inquiries made were from her insurance companies.	Y				X (negatively affected and generally disagrees with practice)

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
48222	This consumer objects to the use of credit history in insurance. Consumer believes she should not be penalized as she has not had any claims and her premiums are always paid on time. Consumer states that other states have eliminated the practice and wishes to know why Iowa cannot follow their lead. The consumer believes this is a form of price gouging and consumers should not be penalized for a credit flaw.	Y				X (generally disagrees with practice)
48084	Consumer received an adverse action notice, and does not believe credit inquiries should be used as a factor to determine insurance costs.	Y				X (disagrees with credit factors considered)
53897	The consumer complained that his insurance was negatively affected by shopping for a new car loan, the number of savings and loan accounts that he has, the number of personal finance accounts opened, and the number of accounts open. He did not understand why he should be negatively affected when he has good credit. Consumer did not understand how the Iowa Insurance Commissioner could condone such a practice. The consumer believed the practice was "dubious". He hopes to see legislation to ban the practice of insurance scoring and would be speaking with his legislative representation.					X (disagrees with credit factors used)

	Summary	Renewal?	Causation	Unfair/Economic	Transparency	Other
54981	The consumer disagrees with his company's decision to begin using insurance scoring. The consumer felt that credit had nothing to do with insurance and that auto premiums should be based on the driving records of those insured. The consumer disagrees that his insurance company should be able to access his credit history without his permission. Consumer was also concerned about the effect insurance inquiries could have on his credit scores.	Y	X			X (privacy Issues)
55758	The consumer's insurance premiums increased due to insurance scoring. The consumer was also concerned that insurance inquiries would have a negative effect on insurance premium.	Y				X (generally disagrees with practice)

F. Appendix 3D: St. Ambrose Report

Use of Credit Scores by the Insurance Industry: Iowa Consumers' Perspective

St. Ambrose University, December 2009

Randy L. Richards, Thomas J. Quinlan, Jr., and Patrick F. O'Leary

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Introduction

In May of 2009, the Iowa Insurance Commissioner's Office contracted with the report authors through St. Ambrose University to conduct a survey of 1,200 Iowa consumers regarding their attitudes, knowledge and beliefs about the use of insurance based credit scoring. The Insurance Commissioner's Office was interested in gathering more data and information on consumers and the practice of insurance based credit scoring.

Using credit scores to determine eligibility and price of insurance is a widely used, though controversial, practice. Many insurance companies believe that an individual with a low credit score has a greater propensity to file an insurance claim.[110] Consumer advocates, state legislators and state insurance regulators believe that this is not true (Cruise, 2003). Several consumer groups want states to ban the use of credit scores in setting premiums for auto and homeowner insurance.[111] Insurers reply that credit behavior is strongly correlated with the tendency to file claims. Other opponents of the use of credit histories charge that the credit history records are full of errors and misinformation.[112] Advocates respond by citing the peripheral nature of most of the errors, on-going attempts to correct them, and methodological problems with these studies.

The insurers' position is supported by actuarial analysis (Miller & Smith, 2003). Critics feel that use of credit scores for insurance policy premiums is unfair (Sage, 2009). Consumer and civil rights groups assert that the use of credit scores discriminates against low-income people and some minorities because their scores tend to be lower (McQueen, 2009; PR Newswire Association LLC, 2007). Perhaps the most important criticism raised is that there exists no convincing causal picture connecting poor credit history with high insurance loss potential (Wu & Guszcza, 2003).

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[110] The following organizations have defended the fairness of insurance credit based scoring: National Association of Mutual Insurance Companies, Property and Casualty Insurers, Insurance Information Institute, The list is not meant to be exhaustive.

[111] The following organizations have questioned the fairness of insurance credit based scoring in whole or in part: Center for Economic Justice, Consumer Federation of America, National Consumer Law Center, National Council of La Raza, National Fair Housing Alliance, Consumers Union of U.S., Inc. The list is not meant to be exhaustive.

[112] (Consumer Federation of America and National Credit Reporting Association, 2002)

The Federal Trade Commission (FTC) found that credit based insurance scoring was an effective predictor of risk and is useful in setting premiums to match the level of risk. The FTC has stated that it lacked sufficient evidence to explain the correlation between claims and credit history (Mohl, 2007). They examined more than two million auto policies.

Insurance commissioners from many states have filed legal briefs against the use of credit scoring by insurance companies. The states have contended that some insurance companies violate the Federal Fair Credit Reporting Act if they do not send consumers adverse action notices when their rates are affected by their credit scores (Total Lawyers, n. d.). These actions by the states suggest that the use of credit scores in the determination of eligibility and rates are considered unfair.

Background

The research questions for this study are:

1. Do Iowans believe that credit scores are valid predictors of risky behavior and insurance claims?
2. What do Iowans know about credit scores generally?
3. Do Iowans believe that using credit scores to determine insurance eligibility and rates is fair?
4. Do minorities receive a disproportionate share of “adverse action” letters from insurers?

To answer these questions we created a survey of 29 questions and distributed it to a randomized, cross-sectional sample of Iowans over 18 year of age. A pilot survey was conducted using a sample size of 96 respondents to establish face validity of the instrument. It resulted in the revision and elimination of some questions. Format and scales were similarly affected and revised accordingly.

Major content includes sections on automobile insurance, homeowner insurance, demographics, and a section covering the use of credit scores.

Table 1

Overview of Survey

Variable name	Research Question	Survey Item
Predictor	Is the use of credit scores a valid predictor of risky behavior and claims?	Questions 5, 10
Knowledge	What do people know about credit scores generally?	Questions 3, 4, 11, 14, 15
Fairness	Is the use of credit scores by the insurance industry fair?	Questions 6 – 9, 13, 16, 17, 28, 29
Adverse	Do minorities receive a disproportionate share of "adverse action" letters from insurers?	Questions 26-27

Using a combination of telephone and Internet approaches, we distributed the final survey and received a total of 1,240 complete responses. Data sources included:

1. MarketTools, Inc. (Zoomerang) (Sparandara, 2009),
2. Personal Market Research (PMR) (Personal Marketing Research, 2009),
3. A supplemental survey of insurance agents that is part of a continuing education study (O'Leary, Quinlan, & Richards, 2009).

Descriptive Statistics

We received a total of some 1300 responses, of which 1,240 were usable: 859 from Zoomerang and 381 from PMR. We removed any cases that showed no ZIP code, and any that provided an out-of-state ZIP code. There was no way of knowing whether these respondents were temporarily living out-of-state or they were individuals who did not follow survey instructions.

Because our survey was a sample, as opposed to a census, the possibility of sampling error is always present. A different sample will likely yield different results. To minimize this, we have established confidence limits of 95 percent around any estimate that we have provided. This means we are 95 percent confident that any sample we might have obtained would have included the values we would have obtained had we taken a census.

In the tables below, we contrast the sample percentage with the state percentage for the variables cited. The state's demographic percentages were read directly, or computed from, the Iowa Data Center tables.

Table 2

Race Distribution

Count	Races	Sample %	State %
1,152	Caucasian (White)	92.90%	93.90%
88	Minorities	7.10%	6.10%
1,240	Total	100.00%	100.00%

Table 3

Age Distribution

Count	Age	Sample %	State %
98	18-24	7.90%	6.42%
161	25-34	12.98%	15.73%
189	35-44	15.24%	21.06%
310	45-54	25.00%	19.47%
482	55 and over	38.87%	37.32%
1,240	Total	100.00%	100.00%
Median		50.55*	

* Higher than state median because it does not include anyone under 18

Table 4

Gender Distribution

Count	Sex	Survey %	State %
474	Male	38.23%	49.30%
766	Female	61.77%	50.70%
1,240	Total	100.00%	100.00%

Table 5

Income Distribution

Count	Income range	Survey %	State %
195	Less than $20,000	15.73%	21.78%
288	$20,000 - 39,900	23.23%	28.89%
296	$40,000 - 59,900	23.87%	22.43%
203	$60,000 - 79,900	16.37%	19.62%
258	$80,000 or more	20.81%	7.28%
1,240	Total	100.00%	100.00%
Median*		$49,256.76	$47,292.00

*As an open ended frequency distribution, only the median for household income can be computed. Although it is a precise computation, the result is an estimate. The median income is estimated as $49,256.76.

Table 6

Metro/Non-metro

Count	Metro/Non-metro	Survey %	State %
801	Metropolitan	64.60%	55.20%
439	Non-metropolitan	35.40%	44.80%
1,240	Total	100.00%	100.00%

Source for state percentages: (State Data Center, 2009)

Grouping of variables: Four groups are identified via deliberate design: 1. Predictor; 2. Knowledge; 3. Fairness; and 4. Adverse.

Data analysis:

Cronbach's alpha (0.687) was used as a reliability check for the survey questions. This is an acceptable result.

For the entire study, the margin of error = ± 2.6%.

Chi-square goodness of fit tests was used on questions 30 – 39 to determine whether the demographics of the survey matched those of the State of Iowa. These tests were also used for question 5 to ascertain whether male and female respondents answered similarly, and for questions 26 and 27 to determine whether adverse actions were disproportionate by race, age, and income.

A two-way analysis of variance (ANOVA) was conducted for the questions where this technique was applicable (questions 11 and 14). As a confirmation, the non-parametric Wilcoxon matched-pair signed-rank test of differences was applied.

Results

Synopses are provided here. Detailed development of these results is in the discussion section below:

Research question #1: Do Iowans believe that credit scores are valid predictors of risky behavior and insurance claims?

A majority (55%) of respondents disagree that credit scores are good predictors of the tendency to file claims. Only 8.7% of respondents believe that insurance companies use credit scores as an indicator of a tendency to file claims. This does not reflect reality (Miller & Smith, 2003; Mohl, 2007; Rejda, 2008), and it suggests a need for consumer education (Government Accountability Office, 2005). A separate survey of Iowa insurance professionals shows them to be about evenly divided as to whether credit scores are valid predictors of a tendency to file claims (O'Leary et al., 2009).

Research question #2: What do Iowans know about credit scores generally?

Iowans' knowledge of the purpose of credit scores is inadequate. A 2005 Government Accountability Office (GAO) report found that most consumers knew what a credit score was, and approximately one-third had obtained their credit scores, but many did not know that some behaviors – such as using all their available credit – could negatively affect their scores. The report also found that several factors were associated with consumers' knowledge. For instance, having less education, lower incomes, and less experience obtaining credit were associated with lower survey scores, while having certain types of credit experiences – such as an automobile loan or a mortgage – were associated with higher scores (Government Accountability Office, 2005). Results obtained in this survey showed that 40% of Iowans had obtained their credit scores, compared to the GAO's finding that one-third of its respondents had done so. Consumer Federation of America and the Providian Financial groups' nationwide studies in 2004 and 2005 of 1000 adults reported that 24% and 31% respectively had obtained their credit reports. Both were below the Iowa study (Consumer Federation of America and Providian, 2005).

Contrary to the GAO's findings, however, our survey found no significant association of credit knowledge with either income or educational levels. 69.2% of our respondents did not select the correct answer when asked the meaning of credit scores. These responses were scattered across the income and education level demographics generally in proportion to their representation. We found no evidence of any disproportionate representation across these demographics.

Research question #3: Do Iowans believe that using credit scores to determine insurance eligibility and rates is fair?

When asked on a personal basis "Do you think **your** personal credit score should affect…" their own ability to purchase insurance or the rates they themselves are charged, the answers were overwhelmingly "No." Respondents seem to think that credit scores should have no bearing on their ability to purchase insurance, nor should credit scores have any relevance to the rates charged. When asked similar questions on an impersonal basis, the results still showed "No," but it was not as definitive or overwhelming. It is possible that any sense of fairness in some respondents might be somewhat offset by hypocrisy. In other words, respondents might expect rules to apply to others, but not to self.

Research question #4: Do minorities receive a disproportionate share of 'adverse action' letters from insurers?

Sixty respondents acknowledged receiving an adverse action notification. A visual inspection of the survey numbers (57 white, 3 minorities) compares very closely with the expectations (56.3 white, 3.7 minorities) based upon the Iowa demographics showing the population to be 93.9% white. The study did not show any evidence of racial bias. However, we did find adverse actions disproportionate to their numbers in the 25-34 age group, and the $40,000 - $59,999 income group.

G. <u>Discussion</u>

Research question #1: Do Iowans believe that credit scores are valid predictors of risky behavior and insurance claims?

Two survey questions address this issue.

Question 5: Which of the following best describes insurance companies' use of credit score? Select ONE only

Summary	
Predicts the likelihood of risky behavior	459
Predicts the likelihood that a person will not be able to pay for insurance	360
Predicts the likelihood that a person will file an auto or homeowners' insurance claim	108
Predicts the likelihood that a person will file false auto or homeowners' insurance claims	65
Don't know	248

Actually, the answer "Predicts the likelihood of risky behavior" is correct. Credit scoring is not a recent phenomenon. At the beginning of the 20th century, credit ratings were given as "high," "good," "fair," and "limited." The reason for deriving these ratings is because it was apparent then, as it is now, that a person's reputation for prompt payment of debts does not necessarily depend upon his estimated financial worth (Huebner, 1916). In other words, risk is different from ability to pay. This concept has stood the test of time.

The answer "Predicts the likelihood that a person will file an auto or homeowners' insurance claim" is also correct, but the respondents did not rank it near the top. It relates to the next question:

Question 10: A person's credit score is a good predictor of how likely they are to file an auto or homeowners' insurance claim.

Agree: 174

Disagree: 686

Neutral: 380

Margin of error = ± 1.9%

There is general agreement with the related choice from question #5 above. The respondents in general do not believe the predictive capabilities of the credit score. It also supports our contention that Iowans in general are aware that credit scores have an effect, but are generally unaware of how extensive that effect is.

There is extremely strong evidence that the incorporation of the use of credit history increases the predictability of claims behavior. A brief review is all we need for our purposes here.

Let's begin with three of the most widely know and publicized studies.

The 2003 EPIC Actuaries study, "The Relationship of Credit-Based Scores to Private Passenger Automobile Insurance Loss Propensity", reviewed more than 2.7 million auto policies (Miller & Smith, 2003). It found that credit based insurance scores are strongly related to an insured's likelihood of filing a claim, and that the use of the scores added significant accuracy to the risk assessment process. Further, these scores measured risk not previously measured by other known rating factors and that they were among the top predictors of risk, outperforming more traditional underwriting factors.

The 2005 Texas Department of Insurance Study, "Use of Credit Information by Insurers in Texas: The Multivariate Analysis", examined hundreds of scores and rating factors for over two million auto and homeowners' policies (Texas Department of Insurance, 2004). "For both personal auto liability and homeowners, credit score was related to claim experience even after considering other commonly used rating variables. This means that credit scores provide insurers with additional predictive information distinct from other rating variables. By using credit score, insurers can better classify and rate risks based on the differences in claim experience."

The 2007 Federal Trade Commission study, "Credit-based Insurance Scores: Impacts on Consumers of Automobile Insurance" found that credit based insurance scoring was an effective predictor of risk under automobile policies (Federal Trade Commission, 2007), and that they were predictive of the number of claims and the total cost of those claims. They examined more than two million auto policies.

Also in 2003 at the request of the NAIC, the American Academy of Actuaries evaluated four studies on insurance credit scoring. The studies were:

1. The Impact of Personal Insurance Credit History on Loss Performance in Personal Lines by James E. Monaghan (2000).(Government Accountability Office, 2005)
2. Insurance Scoring in Personal Automobile Insurance - Breaking the Silence by Conning & Company (2001).(Government Accountability Office, 2005)
3. Predictiveness of Credit History for Insurance Loss Ratio Relativities by Fair, Isaac (1999).(Government Accountability Office, 2005)
4. Use of Credit Reports in Underwriting by the Commonwealth of Virginia, State Corporation Commission, Bureau of Insurance (1999).(Government Accountability Office, 2005)

Based on their review of the four studies and their expertise in the development and review of rating models based on credit history, the Academy members that reviewed *the studies believe that credit history can be used effectively to differentiate between groups of policyholders. Therefore, they believe credit scoring is an effective tool in the underwriting and rating of personal lines of insurance.*" (our emphasis) (Serio, 2003)

Finally, we call attention to the study by Peter Wu and James Guszcza, "Does Credit Scoring Really Explain Insurance Losses? Multivariate Analysis from a Data Mining Point of View" (Wu & Guszcza, 2003). In their Introduction they note:

> One of the more important recent developments in the U.S. insurance industry has been the rapidly growing use of credit scores to price and underwrite personal auto and homeowners insurance. But this development has not come without controversy. Perhaps the most important criticism raised is that there exists no convincing causal

picture connecting poor credit history with high insurance loss potential [1-5][113]. Partly for this reason, many insurance regulators and consumer advocates have expressed doubts that the observed correlations between credit scores and insurance loss history truly reflect an underlying reality. Some critics have suggested that these correlations might be

spurious relationships that would not survive more sophisticated (multivariate) statistical analyses.

They reviewed the prior findings of two studies Tillinghast's, "Credit Reports and Insurance Underwriting," NAIC White Papers, 1997 and James Monaghan's, "The Impact of Personal Credit History on Loss Performance in Personal Lines," CAS Forum, Causality Actuarial Society, 2000 in light of their own research using multivariate analysis and data mining.

Ultimately, they analyzed hundreds of possible predictive variables that they created from the internal and external data sources. Their goal is to create as many variables as possible that might be related to insurance loss and profitability. These variables would represent as wide a range of characteristics as possible about each policyholder.

We have performed several large data mining projects that included credit variables and credit scores. Similar to the Tillinghast study and Monaghan's study, we have studied data from various sources, different distribution channels, and different geographic concentrations. Our studies are very large in size, similar to Monaghan's study, usually with several hundred thousand data points that contain a total of hundreds of millions of dollars of premium. Our approach is tailored to the use of large datasets, the use of train/test methodology, the use of lift curves to evaluate models, and the exploratory use of a variety of modeling techniques. These are all hallmarks of the data mining approach

to statistical problems. We believe that our analyses are true multivariate analyses that yield very robust and credible results. It is precisely this kind analysis that

[113] 1. "Insurance Scoring in Personal Automobile Insurance – Breaking the Silence", *Conning Report,* Conning, (2001). 2. "Insurers Battling Credit-Scoring", *National Underwriter,* March 5th Issue, (2002). 3. "Insurers Lose a Credit Scoring Battle", *National Underwriter,* February 21st Issue, (2002). 4. "Credit Reports and Insurance Underwriting", *NAIC White Papers*, National Association of Insurance Commissioners, (1997). 5. Monaghan, J. E., "The Impact of Personal Credit History on Loss Performance in Personal Lines", *CAS Forum*, Casualty Actuarial Society, (2000). (All as cited in (Wu & Guszcza, 2003).

> makes it possible to decisively answer the question: does credit really help explain insurance losses and profitability?

Their analysis and study confirm what Tillinghast and Monaghan had found. Credit variables effectively predict insurance losses and add measurable and non-reductive predictive power to the other variables. They make it clear that this does not mean that these credit variables “cause” the losses, only that they are undeniably predictive of the losses in the aggregate. “From a statistical and actuarial point of view, *it seems to us that the matter is settled: credit does bear a real relationship to insurance losses*.” (our emphasis).

We think the current evidence for the predictive power of insurance credit scoring is overwhelming. However, perhaps some future research will indicate otherwise but for now we believe reasonable persons must conclude *on the basis of the evidence* the case in favor of the predictive power of insurance credit scoring. Given the predictive power of insurance credit based scoring, the Iowa consumers’ opinions about the efficacy of this method are at odds with the available evidence. Some special attention should be given to educating Iowa consumers about the current facts regarding the strength of this method to predict claims filing behavior because their beliefs about this will have a strong influence on their sense of the fairness of this practice.

Research question #2: What do Iowans know about credit scores generally?

Questions 11 and 14 are a perception/expectation pair. These questions are useful in ascertaining respondents’ knowledge of the factors that are used to compute insurance premiums.

Question 11: (The perception question) A person's auto insurance premium IS based primarily on their: RANK TOP THREE by selecting 1, 2 and 3 next to them

Summary	
Age	2,508
Gender	1,133
History of auto accidents and/or moving violations	2,756
Credit score	594
Number of miles driven annually	991
Other	251

Question 14: (The expectation question) A person's auto insurance premium SHOULD BE based primarily on their: RANK TOP THREE by selecting 1, 2 and 3 next to them

Summary	
Age	2,051
Gender	625
History of auto accidents and/or moving violations	3,130
Credit score	390
Number of miles driven annually	1,427
Other	327

The scores for questions 11 and 14 are weighted. First choice is multiplied by 3; second choice is multiplied by 2; and third choice is counted. The intention of the weighting is to give credibility to the respondents' choices relative to importance.

Questions 14 and 11 represent a perception/expectation pair. It appears that there are different responses between perceptions (IS) and expectations (SHOULD BE).

To ascertain whether this is so, a two-way analysis of variance (ANOVA) was conducted using the weighted scores (p-value = 0.788), and again using the unweighted scores (p-value = 0.831). The result was the same. The hypothesis that perceptions differ from expectations is not supported. As a confirmation, the Wilcoxon matched-pair signed-rank test of differences was conducted with the same result. Perceptions and expectations are not different. It is clear that history of accidents is perceived to be primary in both and the respondents have effectively rank-ordered these elements. (The third and fourth places change rank order between questions 11 and 14).

H. <u>These items are all considered in rate setting, but the methodologies used by insurance underwriters are different. The rank order perceived, and expected, by the survey respondents indicates what they believe to be the most important factors in rate setting. This does not reflect reality (Rejda, 2008).</u>

Questions 3 and 15 were posed to ascertain whether Iowans were interested in knowing their credit status.

Question 3: Do you know your credit score?

Yes: 501

No: 739

Question 15: Have you ever obtained a copy of your credit report (in addition to or separate from your credit score)?

Yes: 730

No: 464

Don't know: 46

The general answer is "Yes," based upon the results of question 15. Credit scores, question 3, are not provided at "no cost." This could explain why a similar number of respondents have not obtained their scores.

Question 4: To your knowledge, which of the following does a credit score MAINLY indicate? RANK TOP THREE

Summary	
Knowledge of consumer credit	1,026
Attitude toward consumer credit	710
Amount of consumer debt	1,969
Risk of not repaying a loan	1,980
Financial resources to pay back loans	1,515
Don't know	347

Again, the scores for question 4 are weighted. First choice is multiplied by 3; second choice is multiplied by 2; and third choice is counted. The intention of the weighting is to give credibility to the respondents' choices relative to importance.

Currently, credit scores are derived through mathematical formulas that assign weights to various credit factors and summarize the results as a three-digit number. Such formulas are proprietary, and usually include outstanding debts, amounts past due, late payments and payment patterns (Rejda, 2008). They also include information from public records, such as bankruptcies and liens.

Those who selected “risk” on this survey have it right. However, they are in the minority. Those who selected “Financial resources” above miss the point that risk and ability to pay are quite different. Misconceptions such as this imply that knowledge of the fundamentals of insurance rate setting is lacking.

Research question #3: Do Iowans believe that using credit scores to determine insurance eligibility and rates is fair?

The questions of fairness standouts as one of the most controversial aspects of the use of insurance credit based scoring for rating and pricing of auto and homeowner’s insurance. Mostly simply, “Is it fair to use a consumer’s credit history as part of the decision on both the acquisition and the rating of auto and homeowners insurance?”

We thought it would be important to use the survey to get a sense of the moral intuition of Iowa consumers about the fairness of the use of insurance credit based scoring. Now let’s be clear from the start, because a person or persons have certain opinions or beliefs about what is fair or not fair does not mean that they are correct.

First, our opinions about what is fair or unfair often are determined by whether we are advantaged or disadvantaged by some decision, policy or practice. Think about how most people evaluate taxes. If they personally benefit from the tax code, they see it as fair. If they feel burdened by it, they decry how unfair it is.

Second, fairness is a complicated concept and one almost entirely contextually driven. Is the concept of fairness in this case one that depends on merit, need, desert or some other factor? I might think it is unfair because I think fairness in this case should depend on merit as a measure and you think it fair because you think fairness in this case should depend on need.

Third, we might be talking about either fair processes or fair outcomes. People are not always clear about which they are referring to nor even be aware of the distinction. When a rich person wins the lottery, we can understand why some people will see this as fair – it is a fair process – random selection. We can also understand why others might say that it is not fair since the winning person does not need the money and so many others were more needy or deserving of the money. In the first case, people look at the process and determine that the lottery is fair. In the second case, they look at the outcome – who won – and declare it is not fair.

Fourth, in referring to the fair distribution of benefits and burdens in society, what criteria do we apply in assessing the relative weights of either the benefits or burdens? Should our measures be relative to all parties in the distribution or against some other independent factor? Should fairness be determined by strict equality – say as in a flat tax like a sales tax. It is fair because everyone pays the same 5%. Or should fairness be determined by equality of burden – say as in progressive income tax. It is fair because everyone makes an equal sacrifice relative to his/her income.

Fifth, is fairness to be rooted only in the effects on particular individuals or can we extend the concept of fairness to society as a whole? If a zoning change will economically benefit the vast majority of people in our area by placing a hog lot operation in the county is it fair to burden the three families whose farms adjoin the hog lot and cannot escape the negative effects? Is it fair for the aesthetic benefit of a mere three families that everyone else in the county be deprived of economic and financial growth?

Sixth, our opinions about fairness will be significantly affected by our depth of knowledge about the issue, and the depth and quality of reflection we have exercised on the issue. The less we know and understand methods and processes of distributions of the benefits and burdens in society the more likely we are to be suspicious of it.

Seven, our sense of what is fair and unfair is also subject to influence by our biases, prejudices and ideological commitments prior to examining the issue. If we are opposed on principle to government intervention, then any government intervention will more likely appear arbitrary and unfair regardless of its justification or effects. If we see government itself as a social mechanism to control and balance the competing forces in society, the government intervention will likely appear as establishing fair and equitable regardless of its justification or outcome.

So as we examine peoples' opinions about fairness, we need to do so carefully. Nonetheless as the Insurance Commissioner's Office and elected representatives consider how to respond to the controversies surrounding the use of insurance credit scoring, we believe they would find it valuable to understand the various opinions Iowans hold. We should, however, make a careful evaluation of these opinions of fairness and critically examine the issues at stake.

Our approach to this difficult problem was to first ask a few questions about some standard insurance practices in rating auto and home owners insurance. We wanted some context to compare Iowa Consumer responses to the practices surrounding insurance credit based scoring.

Let's begin with the practice of charging youthful drivers higher rates. Charging for youthful drivers is and has been standard insurance practice for many years. The rationale?

> Rates for auto insurance for teenage drivers are always higher than any other drivers because they pose a higher risk of accidents than more experienced drivers. Adding a teenager to an insurance policy can mean a 50 percent or even 100 percent increase in the parents' insurance premium (Insurance Information Institute, 2009).

Insurers justify the practice of charging higher rates for youthful drivers based on the simple fact that youthful drivers, ***as a group***, pose a higher risk of accidents and claim activity. Many people point to "lack of experience" as the most plausible explanation for this higher likelihood of claims activity. Others will indicate youthful driver show a lack of judgment, forethought, and understanding of effects of their risky behavior. Obviously, these three vices are not limited to youthful drivers. Some more "experienced" drivers also show lack of judgment, forethought and an understanding of the effects of their risky behavior. We can also agree that some youth drivers do not share these characteristics with their youthful brethren. Yet, they still get charged a higher rate ***because they belong to a group*** that we can show statistically poses a significantly higher accident and claims behavior.

Generally speaking this is not considered a highly controversial issue. We do not have consumer groups or others lobbying the insurance commissioner's office or legislature about prohibiting insurance companies from charging youthful rates because it is unfair. Yet the practice does raise an issue of fairness. We posed the question this way to test respondents' moral intuitions:

Question 16: It is fair practice to charge law-abiding and low-risk individuals higher insurance rates simply because they are part of a group that engages in risky behavior (for example, teenage drivers)?

Agree: 367 (30%)

Disagree: 570 (46 %)

Neutral: 303 (24%)

Margin of error = ± 2.5%

Frankly, we were surprised by this response because there has been little or no controversy surrounding this practice. Less than one third of Iowa consumers think it fair to charge an individual a higher premium merely because he/she is a member of a group that engages in risky behavior. Almost half sees it as unfair.

The question gets at the issue of the fairness of ascribing to me, as an individual, the characteristics of the group of which I am a member. Further, in this case, it is a membership over which I have no control. Since I personally do not possess these characteristics, to ascribe them to me, and then to penalize me (with higher rates) because I belong to this group, may appear patently unfair. Indeed we might argue this is a classic example of bias and prejudice, i.e., because I am a young man, I am likely to engage risky behavior. In our sample, 46% saw this as unfair. Interestingly, this practice, which is universally accepted in insurance underwriting practice as ‘fair’ because it is aimed at young people, would not be allowed if the group upon which it were based was one of race or ethnicity.

Pursuing consumers' opinions of fairness further,

Question 13: People with a higher likelihood of filing insurance claims should pay higher premiums

Agree: 568 (46%)

Disagree: 296 (24%)

Neutral: 376 (30%)

Margin of error = ± 2.7%

The results were almost the opposite. Is this an example of sheer inconsistency? Perhaps. Perhaps not. We think the difference lies in the fact that in this case, respondents understood this to mean the higher likelihood of filing a claim was attributable to *the person as an individual and not a group member*. In such a case where a person as an individual would have a higher chance of filing a claim, then in the opinion of almost half the respondents, it is considered fair that a person pay a higher premium. This opinion is perfectly consistent with the answers on 16. *The rates such people pay should be a function of his/her individual behavior, not some group characteristic.*

Although, we think it is worth remarking that still fewer than half the Iowa consumers agree that those with a higher likelihood of filing claims should pay higher premiums. This was also surprising. We think this should be understood as related to the phrase "higher likelihood." This implies a projection into future behaviors. This person, however, has ***not yet filed*** a claim so he/she should not pay the higher rates. There may be a higher chance that he/she will file a claim, but there is also some likelihood that he/she will not file a claim. The objection to the fairness of this, we conclude, is based *on the projection of likelihood claim activity into the future.*

Understood in this way, the intuition of fairness, for these respondents, would be that the rate I am charged should be based on what I *as an individual have done*. It is unfair to attribute *all of the group characteristics* to me merely because I possess some of the group's characteristics. It is also unfair to charge me rates based on what I might do in the future but have not yet done. It appears to us that these two intuitions are driving many of these responses. It should be noted that these same intuitions will inform respondents' evaluation of the fairness of insurance credit scoring.

Unfortunately, these opinions indicate that Iowa consumers do not have a clear notion of

what it means to spread the risk that is at the heart of the law of large numbers and what theoretically drives insurance as a business. Individuals are surcharged based on what they individually have done, but the base premium is determined by the law of large numbers built around large group characteristics. If the large numbers are reduced to smaller groups of individuals based on increasingly isolated variables, then the base premium of insurance becomes unaffordable to those who need it the most.

This interpretation is reinforced by the responses on Question 29 which is a re-wording of Question 13 except that instead of the more generic "people" we substituted the more personal 'you' in the question.

Question 29: If some factor in your background indicates that you are more likely to file an insurance claim than other people, then it is FAIR that you pay a higher rate for the same insurance product.

Agree: 361 (29%)

Disagree: 499 (40 %)

Neutral: 380 (31%)

Margin of error = ± 2.5%

Our intention in constructing this question was to contrast the difference in people's answers with Question 13. The results comparing the two show what we expected. When Iowa Consumers were asked in 13 the more generic question using "people" should pay higher rates if they have a higher likelihood of filing claims 46% replied affirmatively. But when asked if there was something *in their own background* that indicated that 'you' were likely to file a claim that number drops to 29%. As we indicated above in our opening remarks, intuitions about fairness can be driven by whether I am benefited or burdened by some practice or policy. The responses to this question demonstrate that tendency.

But, beyond that, once again we see *this resistance to the fairness of the practice of using my behavior in the past as a basis for projecting the likelihood of my filing claims in the future.* In question 13, 54% considered this practice either unfair or were not sure of its fairness. In question 29 where we apply this to 'you' that percentage jumps to 71%. Most Iowa consumers do not think it is fair to base auto and homeowners rates on a person's past behavior as a means of determining the probability of their future claims filings. And an overwhelming percentage is opposed *when that person is themselves*.

We are now ready to turn to the intuitions on the fairness of the use of credit scores in securing and rating of auto and homeowners insurance. Let's begin with Questions 17 and 7 that surveyed beliefs about auto insurance rates and credit scores.

Question 17: People with poor credit scores should pay higher auto insurance rates

Agree: 144 (12%)

Disagree: 802 (65%)

Neutral: 294 (24%)

Margin of error = ± 1.8%

Question 7: Do you think your personal credit score should affect the rates you pay for auto insurance?

Yes: 291 (23%)

No: 878 (71%)

Don’t know: 71 (6%)

Margin of error = ± 2.4%

Once again we have paired similar questions but one asks about the generic “people” and the other about the more personal “you.” The surprising thing about this pair of responses is that higher numbers of Iowans consider fair to have the increased rates for lower credit scores when they applied it to themselves. We believe this explained by the fact that in 17 the issue was poor credit scores means higher rates but in 7 the issue was simply that credit scores would *affect your rates*. The difference being that in 7, I might see that my rates would go down if I had a high credit score. However, the more important thing to notice is that in both cases the number opposing this practice is very high, 71% and 65%.

The numbers on homeowners’ insurance ratings are remarkably similar to those regarding auto insurance. We paired Questions 28 and 9.

Question 28: People with poor credit scores should pay higher homeowner insurance rates

Agree: 133 (11%)

Disagree: 779 (63%)

Neutral: 328 (26%)

Margin of error = ± 1.7%

Question 9: Do you think your personal credit score should affect the rates you pay for homeowner's insurance?

Yes: 285 (23%)

No: 880 (71%)

Don't know: 75 (6%)

Margin of error = ± 2.3%

Once again we have paired similar questions but one asks about the generic "people" and the other about the more personal "you." Here, too, higher numbers of Iowans consider it fair to have the increased rates for lower credit scores when they applied it to themselves. Again, we believe this to be partly explained by the fact that in 28 the issue was poor credit scores means higher rates but in 9 the issue was simply that credit scores would affect your rates. The difference being that in 9, I might see that my rates would go down if I had a high credit score. However, as before, in both cases the number opposing this practice is very high, 71% and 63%.

The numbers change only slightly when considering credit scoring should affect the ability to buy auto or homeowners insurance.

Question 6: Do you think your personal credit score should affect your ability to buy auto insurance?

Yes: 237 (19%)

No: 906 (73%)

Don't know: 97 (8%)

Margin of error = ± 2.2%

Question 8: Do you think your personal credit score should affect your ability to buy homeowner's insurance?

Yes: 208 (17%)

No: 966 (78%)

Don't know: 66 (5%)

Margin of error = ± 2.1%

Whether we are referring to auto or homeowner's rates or the ability to buy either auto or homeowners, between 63 and 78 percent of Iowans oppose the practice of using credit history. Why are these numbers so high? What causes people to see this practice as unfair?

We have already seen in our prior discussions about more traditional insurance rating that many hold that it is unfair to use information about one's past history as a basis for projection about whether one is likely to file a claim in the future. Additionally, we have seen that many people hold it is unfair to increase their rates based on a calculation of future likelihood of claim activity based on my membership in a particular demographic group. I should only be accountable for what actually has occurred and is attributable specifically to me.

Understanding these prior opinions on fairness helps us to better understand the reaction to insurance credit based scoring. First past behaviors and histories are being used to project the likelihood I will file a future claim. As we saw earlier, there are strong opinions among many Iowans that this is unfair. But the numbers rejecting this particular practice of insurance credit scoring are higher and less ambiguous than when we were simply using past "information." In the prior cases the percentages finding it outright unfair and rejecting it were much smaller than in this case.

The sense of unfairness in this case is clearly more sharply felt. But is this opinion of unfairness justified? Or, would a deeper look at the issue and practices change our opinions? To look into this issue we need to examine four questions:

1. Does Insurance Credit Based Scoring accurately predict personal lines losses?
2. Is it plausible to believe that the choices persons make in managing their financial

risk are connected with the choices they make managing the risks associated with driving and owning a home?

3. Do the items used by the rating agencies and insurance companies identify financially responsible and financially risky behavior?
4. If the outcomes of the process do not produce results that mimic random distributions, then is that process *ipso facto* unfair?

Let's examine each issue in more closely.

1. Does Insurance Credit Based Scoring accurately predict personal lines losses?

We begin with the question, "Does insurance credit scoring accurately predict claim filing behavior?" If the use of credit scores does not accurately predict future claim filing behavior, then it seems clear that the case for their use falls apart. In section above on the research results of our first question (pages 6-9), we provided extensive documentation that insurance credit based scoring does accurately predict personal lines losses. So to the extent to which someone's opinions about fairness is based on the belief that this method does not work, then that opinion needs to be revised accordingly.

2. Is it plausible to believe that the choices persons make in managing their financial risk are connected with the choices they make managing the risks associated with driving and owning a home?

So let's assume for the moment that the use of insurance credit scoring does accurately predict claim-filing behavior in the future. Can we grant this and still reasonably claim it is arbitrary and unfair? Maybe. We need to ask, Is there any reasonable, plausible and research supportable explanation for how it does this? What if we found a connection between my voting behavior in prior elections and my claim filing behavior? Hypothetically, let's say it turns out that we can show that a pattern of not voting in the prior six local and national elections will show a strong correlation with my claim filing behavior. Those who vote less, regardless of party affiliation, file more claims. Those who vote more file fewer claims. Would it then be unfair for insurance companies to gather and analyze people's voting behavior as part of an insurance rate setting method? If there is little to explain the connection, then it is likely that most people would oppose such practices as unfair even if there was a strong statistical correlation between the two.

Is there a plausible and understandable connection between my credit history and my claim filing behavior or is the connection arbitrary and capricious? Is there any evidence or research that might give some credence, some plausible belief that how I have managed my financial affairs might be predictive of whether or not I will likely file a claim in the future? Is it plausible that how I behave and react to and manage my risk-related affairs in one area of my life may be strongly indicative of how I will behave, react and manage my risk related affairs in other aspects of my life? Might we be looking at patterns of risk management behavior in a person's life that are generally consistent and predicable across broad areas?

Patrick Brockett and Linda Golden argue there is a solid, plausible and research supported explanation as to why credit scoring predicts auto insurance claims. In their 2007 article, "Biological and Psychobehavioral Correlates of Credit Scores and Automobile Insurance Losses: Toward an Explication of Why Credit Scoring Works," they connect increased auto claims with a life pattern of risk-taking behavior across a multiple dimensions of a person's life (Brockett & Golden, 2007). They note in their Abstract:

> However, in spite of its obvious success as an underwriting tool, and the clear actuarial substantiation of a strong association between credit score and insured losses over multiple methods and multiple studies, the use of credit scoring is under attack because there is not an understanding of why there is an association. … Credit scoring can give information distinct from standard actuarial variables concerning an individual's biopsychological makeup, which then yields useful underwriting information about how they will react in creating risk of insured automobile losses.

Brockett and Golden review in specific detail the biological, psychological, and behavioral literature searching for characteristics of individual risk taking and sensation seeking behaviors and connect these characteristics with both financial decision making and risky driving habits. They argue that certain biochemical and psychobehavioral elements of risk taking attitudes and behavior are not confined to a specific area in life. Rather, these behaviors extend across multiple areas of a person's life. They note, citing the studies of Kellison et al, 2003, Miller and Smith, 2003 and Wu and Guszcza, 2003, that the correlation between credit scores and insurance losses persist even after the effects of traditional underwriting variables are factored out. They conclude that credit scores are, therefore, revealing a new and distinct aspect of individual risk-taking behavior.

> Credit scoring "works" because it provides a numerical proxy for the biopsychobehavioral makeup of the individual that affects insurance losses. It yields additional information about one's responsibility and stability, stress level,

and distractibility, all of which influence the amount of insured losses paid by the insurance company.

While Brockett and Golden focused their attention on the connection between risk taking and sensation seeking behavior in driving and financial management, Winfred Arthur, Jr. and William Graziano found a connection between driving accidents and lack of conscientiousness (Arthur & Graziano, 1996). To appreciate their study, we need some brief background on the Five Factor Model (FFM).

In 1958 and again in 1961, Ernest Tupes and Raymond Christal conducted seminal studies of Air Officers revealing that five basic factors of personality were responsible for describing a wide range of behavior (Tupes & Christal, 1958; Tupes & Christal, 1961). Subsequent studies, with minor variations, have discovered these same five factors among different subjects, regardless of age or gender and in different languages and cultures. Other studies have shown the five factors to be valid and systematically related to behavior, and to endure across decades in adults. In the last two decades, dozens of studies have used the FFM to describe and explain a wide variety behavior across multiple realms of human activity. FFM proponents believe they have discovered the basic dimensions of personality rooted in both heredity and environment.

The acronym CANOE sets forth the names of the five factors: Conscientiousness, Agreeableness, Neuroticism, Openness, and Extroversion. For purposes of this paper, it is only necessary to explain Conscientiousness. Conscientiousness is characterized by feelings of competence and capability, neatness, attentiveness to duties and responsibilities, diligence, purposefulness, self-discipline, persistence, and cautious deliberation.

In their article "The Five-factor Model, Conscientiousness, and Driving Accident Involvement." in the 1996 Journal of Personality, Arthur and Graziano employ the Five Factor Model to understanding automobile accidents. Their research revealed that in a sample 477 respondents, that results generally showed a significant inverse relationship between those who rated themselves as more disciplined, reliable, and dependable (characteristics of Conscientiousness in the Five Factor Model) and automobile accidents. This finding is consistent with a large number of other studies demonstrating a consistent pattern of relationship between Conscientiousness and other positive tasks and behavioral outcomes. Persons scoring high on the Conscientious scale tend to regulate themselves during instances of frustration and stress (Digman & Takemoto-Chock, 1981). Those prone to criminal behavior show an absence of self-control in such instances (Gottfredson & Hirschi, 1990). Conscientious persons have the lowest likelihood of a history of family alcohol abuse, and tend not abuse alcohol themselves (Martin & Sher, 1994). Lower conscientiousness was part of the profile of workers with higher absenteeism from the job (Furnham & Bradwell, 2006). One of the characteristics of pathological gamblers was a low score on the Conscientious scale (Bagby et al., 2007). Highly conscientious individuals were more likely to wear seat belts, utilize alcohol-related harm reduction, exercise, get enough sleep, and consume fruits and vegetables (Raynor & Levine, 2009).

The research on the Five Factor Model (FFM) is robust and has been shown to be effective across cultures. The evidence is clear that conscientiousness extends broadly across multiple aspects of a person’s life and affects choices and behaviors consistently. So, like the research by

Brockett and Golden, the FFM would indicate *there is a connection between one's financial choices and the choices one makes in one's driving (and homeownership), and those choices are driven by the degree of conscientiousness one exercises in both realms*. In this way, if insurance credit scoring is indicative of the financial choices one makes, then we would expect the behavioral basis of those choices to be reflected in one's driving and homeowner's behavior. If this is so, then our opinions of fairness may change to reflect that recognition of the connection.

The fact that insurance credit scoring does predict claim filing behavior, together with the research on behavioral patterns that are consistent and explanatory across different aspects of our lives, strongly suggest that such a connection exists between risky behavior in one area with risky behavior in another.

Auto accidents are caused by one or more of the drivers making an error in judgment – someone took an unnecessary and unwarranted risk. If they had it to do over again, likely they would choose a different course of action because *they can now see clearly the consequences of their choices*. They would slow down, proceed with more caution, be more attentive to what is going on around them, not consume alcohol, not text-message or eat while driving. They would make better driving adjustments to the conditions instead of treating all environments as if they were sunny afternoons with high visibility, a dry pavement and no other drivers on the road. They would exercise greater awareness of their situation and cautious decision-making in their driving. In short, they would be more conscientious in the driving behavior.

Is it possible to find predictors of those who would exercise more or less conscientiousness while driving? Underwriting is in part a search for and application of the findings of those predictors. As Brockett and Golden point out:

> Many underwriting variables are clearly related to the losses they are designed to predict (e.g., automated sprinkler system installation for insured fire loss, seat belt and security alarms for automobile insurance, employment activity for workers compensation insurance, etc.) and have been used for decades. Others (e.g., marital status, gender, and "good student" status in automobile insurance) are also of long standing; however, the relationship between the variable and the loss it is intended to predict is less readily apparent. *In fact, their usefulness as an underwriting variable stems from their being a proxy for stability and responsibility not from their direct link to automobile accidents.* (our emphasis). (Brockett & Golden, 2007).

The parallel case can be made with a person's financial credit choices. In retrospect, regardless of what the bank or realtor said, was it really wise for me to borrow 100% of the money for my house? How much of my monthly pay should go to my house – perhaps 50% is too much? Is it really smart to buy and charge all of these things on my credit card? How will I pay the bills if I unexpectedly get sick, injured, or fired? Are my savings sufficient to protect me in these situations? Do I need the latest of everything? I would not act as if I was on an economic highway that was sunny, with dry pavement, no curves and no others "drivers" out there. I would plan for and adjust my financial behavior based on knowing that there are very real risks out there: the economic highway has rain, curves, ups and downs and dangerous intersections. In short, now that I see the consequences of my actions, I would do things differently. *I would exercise more conscientiousness and attentiveness to my finances.*

If we could pick out the people who do this who give more forethought, deliberate more reflectively on the choices given the financial risks they faced, then the expectation is that these same folks will also be more conscientious drivers and homeowners confronting the risks they face. Given the behavioral and statistical evidence, it is a plausible, though not an absolutely certain expectation. It would depend on a number of other factors, but certainly it is plausible to see this *as one of the factors to consider*.

3. Do the items used by the rating agencies and insurance companies identify financially responsible and financially risky behavior?

Now it is beyond the scope and expertise of the authors to know if the dozens of factors that are used in insurance credit based scoring by its various practitioners actually identify financially responsible and financially risky behavior. Some may and some may not. However, if those with this kind of expertise determine that these factors are able to pick out these financially cautious, risks aversive, conscientious people then we believe the case for the fairness of the practice increases, otherwise, not.

4. If the outcomes of the process do not produce results that mimic random distributions, then is that process *ipso facto* unfair?

Since the insurance credit based method does not use race or ethnicity as a factor, there can be no direct discrimination. But there is some evidence, inconclusive and mixed, that, although racial and ethnic minorities are found at all levels of insurance credit scores, they are "over represented" in the bottom scores, "over represented" being under defined. This taken by critics that this is, *de facto*, unfair. Borrowing a concept from employment law and practice, they claim it amounts to either adverse impact or adverse selection or both. Defenders of insurance credit based scoring counter by saying that clearly there is no overt discrimination and that it is improper to import employment-based concepts into the insurance area and that if turns out that it is proper then under the employment practices model, adverse impact/selection is allowable so long as there is a valid business reason.

Rather than address this question directly, we would like to explore why people may have different opinions about what is fair under such a situation as this.

Let's begin with the question: Does fairness mean that an equal percentage of each and every ethnic /economic group be represented in each category? That their representation in each category would be roughly the same as in the general population?

Suppose,

1. The Coodbeyoo represent 15% of the population of Welivehere.
2. There are 10 rating categories – from the worse to best categories of insurance rates.

   Does fairness require that roughly 15% of each category be composed of Coodbeyoos? Suppose there are 100,000 people in Welivehere. Most simply, 10,000 people would be found in each of the ten categories. Hence, do you expect that if the distribution were fair then roughly 1,500 Couldbeyoo would be in each category?

   So that we think that fairness in the distribution of Coodbeyoos should approximate what we would produce if we randomly dropped marbles into a set of ten boxes. If we had 100,000 marbles of which 15,000 were blue marbles, we would about 1,500 blue marbles in each box. Fairness under this understanding is closely tied with a strong notion of numerically equal distributions.

   What if Welivehere was an elite university and the Coodbeyoo were those students whose parents did not go to college. We rank student performance in 10 performance categories. Would we expect those students to be equally distributed in each one of the performance categories?

   What if the evidence showed that Coodbeyoo were more likely to be in the bottom categories, although there were Coodbeyoo in all categories and the professors had no records indicating who the Coodbeyoo in their classes were. No one knows exactly why the Coodbeyoo are over represented (in comparison to a random selection distribution). Speculations abound on the reason behind the correlation.

Would this be an indication of an unfair grading system? Does this non-random distribution indicate some hidden bias against the Coodbeyoo? Have the Coodbeyoo been treated unfairly as a group? Should we change the grading system so that the distribution of Coodbeyoo more closely resembles the random distribution of blue marbles?

Let's say we did change the grading system and now we have a distribution of Coodbeyoo that more closely resembles the random distribution of blue marbles.

So now we ask you to vote choose between the two systems on the basis of what is more fair?

Which would you choose between the two? Do you choose the original grading system where Coodbeyoo were "over represented" in the bottom groups? Or do you choose the new grading system that distributes the Coodbeyoos more equally across the performance categories?

Does the fact that the new system produces a more random like result *make it appear to be more fair?* We think most people's intuition would be that it does and they would choose the second system.

But, suppose we understand that grades are meant to distinguish among students who perform well or poorly on a variety of academic tasks. Let's say the second system does that, but it does not do it as well as the first system: it looks at fewer tasks, aggregates the performance differently, etc. Then we might plausibly argue it less fair because those that performed the academic tasks better would not be properly measured and rewarded. In that case, people's intuitions may be that the first system was more fair.

But that may not hold true with everyone. Suppose it turns out that student grades have a big impact on who gets hired and what they are paid following graduation. *Then the effect of each system on the lives of the Coodbeyoo will be significantly different*. Under the first system, Coodbeyoo alumni, as a group, are not as likely to earn as much over their lifetime, as their non-Coodbeyoo classmates. Does our intuition on fairness still hold?

Could we hold that yes the first system does a better job of distinguishing academic performance but the second one a) still distinguishes academic performance and b) the difference between the two grading systems is not so large that we should allow it determine a person's life time earnings? We think many of us would hold, looking at the whole picture not just what happens the university, the second system would be more fair.

But this assumes that the effect on the non-Coodbeyoo is neutral. What if the change in the grading system negatively affects their postgraduate earning power? If we implement the second system then their earning potential drops by a significant percent because it does not accurately report their true abilities. Suddenly we might lurch back in the other direction.

The Coodbeyoo example reflects the situation with ICBS. Proponents believe the method is fair because *the process is the most accurate predictor of claims filing behavior* and the method, like the Coodbeyoo professors, does not have information on race or income levels. That they use a fair process allows them to call the results fair. Not only that, but we will not be able to benefit those with lower scores without increasing the rates of the others in the pool which would be unfair to them. So the process is fair and so is the outcome.

Some opponents believe that because the distribution of certain groups does not resemble a random dropping of blue marbles into multiple boxes *then ipso facto the system is unfair in its outcomes* as it relates to *the consequences* for low-income insureds.

These differences of the intuitions of fairness are difficult to reconcile and overcome.

We think all should agree that the process itself must be impartial and do what it says: it does not identify race, ethnicity or income and it does predict losses. If these are true, *then we have a fair process and that is important*.

But what about the outcomes? It is hard to imagine that we would not consider the effects of the process if for no other reason than to see if it can be improved. But in examining the outcomes, we cannot escape the fact that those with higher credit scores will pay more if we abandon their use. We also think we would be hard pressed to find any system where the distribution of the benefits and burdens of social cooperation end in a distribution pattern that mimics random selection.

Perhaps, we might ask, “Do we think of fairness as a yes/no matter – like an on/off switch or is fairness to be thought of as matter of degree – like a dimmer switch?” Upon reflection, we think most people would see it as a matter of degree. We do not expect any process to produce perfect results. *Rather, we are looking to see if this rating process generally and for the most part picks out those people whose behavior creates extra losses in the system for which they are, at least in part, responsible.* We can believe this and still believe that certain individuals are being unfairly burdened by the process because it takes no account of their personal situation.

Credit scores play "...an increasingly critical role in determining the financial fortunes of consumers:..." (Washington Post, 2009). Use of credit scores in making the determination of risk and subsequent pricing is often justified by the belief that low credit scores are a result of a series of bad decisions (Glater, 2009). While true, it is only one cause of low credit scores. Low credit scores can also be caused by death, divorce, incarceration, military deployments, major medical problems, etc. Some of these are not the fault of the individual, and could possibly be traced to insensitivity or even vindictiveness on the part of entities reporting to the credit agencies.

Can we find a way to address this? Let's return to case of youthful driver rating and the unfair way in which our exemplary youth is treated by being lumped in with his less than conscientious brethren. Insurance companies do find ways to make allowances for this through a variety of mechanisms: good student discounts (which signal more conscientious behavior in school and suggest more conscientious behavior behind the wheel), reduction in rates for extended periods of time without accidents or moving violations (again suggestive of more conscientious behavior), etc.

Could we not find a comparable mechanism in these cases – a few objective indicators that this person did not act in a less than conscientious fashion but was a victim of circumstance beyond his/her control? If such a method could be developed, then we might believe that the process was more fair.

We would also expect the careful and constant examination of the factors that are used in insurance credit based scoring by its various practitioners to ensure they actually identify financially responsible and financially risky behavior. This, too, would make the system more fair.

Research question #4: Do minorities receive a disproportionate share of "adverse action" letters from insurers?

With respect to the question whether minorities are disproportionately receiving adverse insurance actions based on their credit scores we asked in Question 26: Have you ever received a letter from your insurance company stating that your insurance rates had been raised due to your credit score? The results were:

Yes: 60

No: 1,135

Don't know: 45

The 60 who acknowledged receiving an adverse action notification constitute an insufficient sample size upon which to run a chi-square test to compare the results against the racial demographics. However, visual inspection of the survey numbers (57 white, 3 minorities) compares very closely with the expectations (56.3 white, 3.7 minorities) based upon the Iowa demographics showing the population to be 93.9% white.

We did find adverse actions disproportionate to their numbers in the 25 - 34 age group, and the $40,000 - $59,999 income group.

Question 27 asked: “Has your insurance agent ever shared with you how your credit score affects your auto and homeowners' insurance rates?

The results of this inquiry are:

Yes: 82

No: 1,097

Don’t know: 61

It should also be pointed out that of the 60 adverse actions noted above, 19 (32%) acknowledged that their insurance professional had shared with them the effects of credit scores on insurance pricing. 39 (65%) stated that they were unaware, and 2 (3%) acknowledged that they did not know whether their agent had shared this information with them. Based on the results of another study, 71% of insurance professionals stated that they share this information with their clients (O'Leary et al., 2009). Across the entire database, only 7% of recipients of adverse actions acknowledged that they had been so notified. This may be a case of selective memory, or the agents believe that perhaps including such information in the fine print constitutes notification. Nothing more can be inferred.[114]

Credit scores play "...an increasingly critical role in determining the financial fortunes of consumers:..." (Washington Post, 2009). Use of credit scores in making the determination of risk and subsequent pricing is often justified by the belief that low credit scores are a result of a series of bad decisions (Glater, 2009). While true, it is only one cause of low credit scores. Low credit scores can also be caused by death, divorce, incarceration, military deployments, major medical

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[114] There is litigation concerning insurance companies’ handling of adverse actions (Total Lawyers, n. d.).

problems, etc. Some of these are not the fault of the individual, and could possibly be traced to insensitivity or even vindictiveness on the part of entities reporting to the credit agencies.

Conclusions and Recommendations

As the Iowa Insurance Commissioner's Office and elected representatives consider how to respond to the controversies surrounding the use of insurance credit scoring, we believe they will find it valuable to understand the various opinions Iowans hold. Most Iowans believe that the use of credit scores to set rates is unfair. These opinions seem to be based on widely-held, but incorrect, perceptions that credit scores are not predictive of risky behavior that might lead to a tendency to file claims. There does not appear to be a factual basis for these opinions. For this perception to be true, the following conditions would have to be true:

1. Insurance Credit Based Scoring does not accurately predict personal lines losses.
2. The choices a person makes in managing their financial risk are not plausibly connected with the choices they make managing the risks associated with driving and owning a home.
3. The items used by the rating agencies and insurance companies do not identify financially responsible and financially risky behavior.
4. If the outcomes of the process do not produce results that mimic random distributions then the process is *ipso facto* unfair.

Our examination shows that Item 1 is clearly and demonstrably false. For Item 2, we saw there is plausible behavioral theory and research to connect risk behaviors and management across multiple dimensions of a person life. For Item 3, experts in managing financial risk generally agree these are relevant factors. Item 4, is highly debatable. If any of these conditions changed then we would have to re-examine our conclusion but given what we believe to be the case today, the belief that this is unfair lacks the necessary justification for the claim.

We suggest that the best way to look at the fairness question is not to see the practice as fair or unfair but to look at as more or less fair. For something to be thought of as fair it is not necessary that there be no examples of unfairness. Rather that the process is impartial and produces largely and for the most part fair individual outcomes. Where it does not, then there should exist some mechanism to address the imperfection in the process.

We also believe that legislators and policy makers should make a careful evaluation of these opinions, especially as they relate to fairness. It will be necessary to examine critically the issues at stake before pursuing any ban on the use of credit scores to set insurance rates.

Consumers are seriously uninformed about insurance fundamentals. Iowa consumers do not have a clear notion of what it means to spread the risk. Although individuals are surcharged based on what they individually have done, the base premium is built around large group characteristics. If the large groups are reduced to smaller groups of individuals based on increasingly isolated variables, then the base premium of insurance will become unaffordable to those who need it the most. A policy recommendation to the legislature might include a block of instruction at the high school level on both insurance and the wide-ranging effects of credit scores. This need not be a semester length course, but should be included with training for other adult skills like maintaining a checkbook and the use of credit cards, etc.

There is no evidence within this study to suggest that the minority population of Iowa is disproportionately subjected to adverse actions based on the use of credit scores.

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Authors Profile

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Thomas J. Quinlan, Jr. has retired as an Associate Professor of Finance, Economics, and Decision Sciences in the College of Business at Saint Ambrose University. He taught statistics and operations management at both graduate and undergraduate levels. In a prior career, Dr. Quinlan developed the industrial modernization plan for Rock Island Arsenal. He investigated unexplored areas of manufacturing technology and determined independently the technical action necessary to accomplish objectives, facets of which extended beyond available precedents and guidelines. Dr. Quinlan is currently involved in assessing the efficacy of continuing education for insurance professionals. He received his Bachelor of Science degree from Drexel University, and he holds M.B.A. and D.B.A degrees from St. Ambrose University. He joined the St. Ambrose University faculty in 1989 after a career in the United States Army.

Patrick O'Leary teaches management and international business at St. Ambrose University. Born and raised in Ireland, he received his graduate degrees from the Universities of Washington and Iowa. He has taught management in diverse regions of the world, spending several years in Japan and Dubai, and has been a visiting professor at colleges in Russia and Croatia. His research interests are in cross-cultural management as well as service efficiency and effectiveness. Presently he is investigating the efficacy of continuing education for insurance professionals as well as the rationale for different approaches to the valuation of illiquid assets. He has been published in the International Journal of Health Care Quality Assurance, Ivey Publishing, the American Journal of Distance Education, and others.

Appendix

Descriptive results for the individual questions follow:

Question 1: Do you have auto insurance?

Yes: 1,152

No: 88

Question 2: Do you have homeowners insurance?

Yes: 985

No: 255

Question 3: Do you know your credit score?

Yes: 501

No: 739

Question 4: To your knowledge, which of the following does a credit score MAINLY indicate? RANK TOP THREE

Summary	
Knowledge of consumer credit	1,026
Attitude toward consumer credit	710
Amount of consumer debt	1,969
Risk of not repaying a loan	1,980
Financial resources to pay back loans	1,515
Don’t know	347

These are weighted scores. First choice is multiplied by 3; second choice is multiplied by 2; and third choice is counted. The intention of the weighting is to give credibility to the respondents’ choices relative to importance.

Question 5: Which of the following best describes insurance companies' use of credit score? Select ONE only

Summary	
Predicts the likelihood of risky behavior	459
Predicts the likelihood that a person will not be able to pay for insurance	360
Predicts the likelihood that a person will file an auto or homeowners' insurance claim	108
Predicts the likelihood that a person will file false auto or homeowners' insurance claims	65
Don't know	248

To ascertain whether male and female respondents answered this question similarly, a chi-square goodness-of-fit test was conducted. The test shows that males and females had significantly different answers (p-value = 0.0006). The major difference is that male respondents, disproportionately to female respondents, believed that insurance companies use credit scores to predict the likelihood that a person will file an auto or homeowners' insurance claim. The other, less significant, difference was that a disproportionately higher number of female respondents suggested that they did not know which of the choices best described an insurance company's use of credit scores.

Question 6: Do you think your personal credit score should affect your ability to buy auto insurance?

Yes: 237

No: 906

Don't know: 97

Margin of error = ± 2.2%

Question 7: Do you think your personal credit score should affect the rates you pay for auto insurance?

Yes: 291

No: 878

Don’t know: 71

Margin of error = ± 2.4%

Question 8: Do you think your personal credit score should affect your ability to buy homeowner's insurance?

Yes: 208

No: 966

Don’t know: 66

Margin of error = ± 2.1%

Question 9: Do you think your personal credit score should affect the rates you pay for homeowner's insurance?

Yes: 285

No: 880

Don’t know: 75

Margin of error = ± 2.3%

Question 10: A person's credit score is a good predictor of how likely they are to file an auto or homeowners' insurance claim.

Agree: 174

Disagree: 686

Neutral: 380

Margin of error = ± 1.9%

See also question #5. 108 of 1240 suggested this as a potential use by insurance companies.

Question 11: A person's auto insurance premium IS based primarily on their: RANK TOP THREE by selecting 1, 2 and 3 next to them

Summary	
Age	2,508
Gender	1,133
History of auto accidents and/or moving violations	2,756
Credit score	594
Number of miles driven annually	991
Other	251

Question 12: Insurance companies should be allowed to use all publicly available data to determine an individual's insurance risk and premium

Agree: 421

Disagree: 444

Neutral: 375

Margin of error = ± 2.6%

Question 13: People with a higher likelihood of filing insurance claims should pay higher premiums

Agree: 568

Disagree: 296

Neutral: 376

Margin of error = ± 2.7%

Question 14: A person's auto insurance premium SHOULD BE based primarily on their: RANK TOP THREE by selecting 1, 2 and 3 next to them

Summary	
Age	2,051
Gender	625
History of auto accidents and/or moving violations	3,130
Credit score	390
Number of miles driven annually	1,427
Other	327

Question 14, along with question 11, represent a perception/expectation pair, and there are visibly different responses between perceptions (IS) and expectations (SHOULD BE). Analysis of variance techniques showed that the differences are not statistically significant. History of accidents is perceived to be primary in both.

Question 15: Have you ever obtained a copy of your credit report (in addition to or separate from your credit score)?

Yes: 730

No: 464

Don't know: 46

A similar question "Have you ever viewed your credit report?" was asked in a GAO survey (Government Accountability Office, 2005). 58% responded that they had.[115]

[115] It should be noted that credit reports can be obtained free annually from http://www.annualcreditreport.com

Question 16: It is fair practice to charge law-abiding and low-risk individuals higher insurance rates simply because they are part of a group that engages in risky behavior (for example, teenage drivers)?

Agree: 367

Disagree: 570

Neutral: 303

Margin of error = ± 2.5%

A chi-square contingency table test for this question compared the *Agree/Disagree/Neutral* responses against age groups and found that the age group most adversely affected by this practice (18 – 24) was the only one that had a plurality agreement. It is possible that this result could be attributed to youthful idealism or naïveté. (P-value = 0.0003, a very definitive result).

Question 17: People with poor credit scores should pay higher auto insurance rates

Agree: 144

Disagree: 802

Neutral: 294

Margin of error = ± 1.8%

Question 18: Have you ever had an auto accident for which you did not file a claim?

Yes: 549

No: 691

Question 19: If yes to above question 18, did you

Summary	
Go without repairs?	141
Pay the expenses out-of-pocket?	249
Allow other party to pay?	104

Question 20: If you had an auto accident for which you did not file a claim, approximately how much did the repairs cost?

Based on the frequency distribution, the median is $401.34. In many cases, the amounts reported as repairs were less than the deductibles. This explains the reason for non-reporting. Because of an open-ended class, neither the standard deviation nor the mean can be estimated.

Question 21: If you had an auto accident for which you did not file a claim -- why did you not report it?

The most common reasons given involved minimal damage and amounts less than deductible (223), fear of premium increases (82), and several reasons with frequencies of fewer than 15 each. These included uninsured, insufficient coverage, the "hassle" of filing claims, and damage that exceeded the value of the vehicle.

Question 22: Have you ever had damage to your home for which you did not file a claim?

Yes: 291

No: 949

Question 23: If yes to above question 22, did you

Summary	
Go without repairs?	57
Pay the expenses out-of-pocket?	57
Allow other party to pay?	0

Question 24: If you had damage to your home for which you did not file a claim, approximately how much did the repairs cost?

Based on the frequency distribution, the median is $614.55. The amounts reported as repairs were frequently less than the deductibles. This explains the reason for non-reporting. Because of an open-ended class, neither the standard deviation nor the mean can be estimated.

Question 25: If you had damage to your home for which you did not file a claim -- why did you not report it?

The most common reasons given involved minimal damage and amounts less than deductible (152), fear of premium increases (74), insufficient coverage (20), and several reasons with frequencies of fewer than 10 each. These included uninsured, the “hassle” of filing claims, damage that exceeded the value of the property, and ignorance of policy provisions.

Question 26: Have you ever received a letter from your insurance company stating that your insurance rates had been raised due to your credit score?

Yes: 60

No: 1,135

Don’t know: 45

Question 27: Has your insurance agent ever shared with you how your credit score affects your auto and homeowners' insurance rates?

Yes: 82

No: 1,097

Don’t know: 61

Question 28: People with poor credit scores should pay higher homeowner insurance rates

Agree: 133

Disagree: 779

Neutral: 328

Margin of error = ± 1.7%

Question 29: If some factor in your background indicates that you are more likely to file an insurance claim than other people, then it is FAIR that you pay a higher rate for the same insurance product.

Agree: 361

Disagree: 499

Neutral: 380

Margin of error = ± 2.5%

Question 30: Is your age between

18-24: 98

25-34: 161

35-44: 189

45-54: 310

55-65: 321

Over 65: 161

Question 31: Are you

Male: 474

Female: 766

Question 32: Education level

Some High School: 12

High School diploma: 365

Associates degree: 220

Bachelor's degree: 249

Masters: 155

Doctorate: 103

Other, please specify: 136

Question 33: Marital status

Currently married: 679

Formerly married: 379

Never married: 182

Question 34: Number of dependents

Mean = 1.407

Standard deviation = 0.036

Question 35: How would you describe yourself?

Caucasian (White): 1,152

African-American (Black): 46

Hispanic/Latino: 12

Native American (Indian): 7

Asian: 4

Other: 19

Question 36: Employment

Full-time worker: 597

Part-time worker: 141

Student: 43

Homemaker: 95

Retired: 242

Unemployed: 75

Other: 47

Question 37: Job title, if applicable

Not used.

Question 38: Residential ZIP code

Metropolitan area: 802

Non-metropolitan area: 439

Question 39: Household income last year - includes salaries, pensions, social security and other money received.

Less than $20,000: 195

$20,000 - 39,900: 288

$40,000 - 59,900: 296

$60,000 - 79,900: 203

$80,000 or more: 258

J. Appendix 4A: Iowa Economic Data[116]

Increase in State of Iowa Unemployment from 2007-2009

2007-2008	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Resident Unemployed *	62.6	63	63.4	63.9	64.4	64.9	65.5	66.1	66.9	67.6	68.4	69.3
Percent Unemployed	3.8	3.8	3.8	3.8	3.8	3.9	3.9	3.9	4	4	4.1	4.1

2008-2009	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Resident Unemployed *	70.1	71	71.9	72.8	73.7	80	81.9	87.5	84.9	95.8	103.5	108.3	114
Percent Unemployed	4.2	4.2	4.3	4.3	4.4	4.8	4.9	5.2	5.1	5.7	6.2	6.5	6.8

*Figures are shown in thousands (Example - 62,600 is printed 62.6)

Population

Over 18 years: 2,273,148

Over 65 years: 438, 504

2010 Iowa Bankruptcy Filings (Chapters 7, 13)

2008	2009	2010
7,964	10,037	9659

[116] Iowa unemployment information: Iowa Workforce Development. *Labor Force Data*. (at http://www.iowaworkforce.org/lmi/laborforce/index.html)

Population information: U.S. Census Bureau, *2006-2008 American Community Survey*. (at http://factfinder.census.gov/)

Bankruptcy Information: U.S. Courts. *Bankruptcy Statistics*. (at http://www.uscourts.gov/bnkrpctystats/bankruptcystats.htm); http://www.iasb.uscourts.gov/BkStats/BkStats.shtm

K. Appendix 4B: List of Additional Regulator Studies on Insurance Scoring

States/ Agencies	Insurance Scoring Reports and Information
Alaska	(2003) http://www.naic.org/documents/topics_credit_scoring_ak.pdf
Arkansas	(2009) http://www.insurance.arkansas.gov/administration/Reports/2009Credit.pdf
FTC	(2007) http://www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insurance_Scores.pdf
FTC	(2007) http://www.ftc.gov/os/testimony/P044804_Credit-based_Insurance_Scores.pdf
Kansas	(2005) http://www.kspace.org/bitstream/1984/90/1/KS_Insurance_Score_Act_Report_2004.pdf
Maryland	(2004) http://www.mdinsurance.state.md.us/sa/documents/2004CreditScoringReportplusEx1rev.pdf
Michigan	(2002) http://www.michigan.gov/documents/cis_ofis_credit_scoring_report_52885_7.pdf
Missouri	(2004) http://insurance.mo.gov/reports/credscore.pdf
Nevada	(2006) http://www.doi.state.nv.us/G-AutoGuide-03-15-06.pdf (p. 18)
Nevada	(2009) http://www.doi.state.nv.us/Laws-B-09-004.pdf
Texas	(2004) http://www.tdi.state.tx.us/reports/documents/creditall04.pdf
Texas	(2005) http://www.tdi.state.tx.us/reports/documents/credit05sup.pdf

States/ Agencies	Insurance Scoring Reports and Information
Utah	(2008) http://www.insurance.utah.gov/docs/rules/R590-219.pdf
Utah	(2009) http://www.insurance.utah.gov/auto/CreditReports.html
Virginia	(1999) Commonwealth of Virginia 1999 Report of the State Corporation Commission's Bureau of Insurance on the Use of Credit Reports in Underwriting to the State Commerce and Labor Committee of the General Assembly of Virginia (not available online)
	(2009) http://www.scc.virginia.gov/division/boi/webpages/inspagedocs/creditscoring.pdf
Washington	(2003) http://www.insurancescored.com/Final_SESRC_Report.pdf